S. HRG. 101-1058

# THE FEDERAL DEPOSIT IMPROVEMENTS ACT OF 1990

## HEARING

BEFORE THE

## COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

ON

## S. 2827

TO IMPROVE THE ADMINISTRATION OF THE FEDERAL DEPOSIT INSURANCE CORPORATION AND TO MAKE TECHNICAL AMENDMENTS TO THE FEDERAL DEPOSIT INSURANCE ACT

JULY 19, 1990

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

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# THE FEDERAL DEPOSIT IMPROVEMENTS ACT OF 1990

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THURSDAY, JULY 19, 1990

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
*Washington, DC.*

The committee met at 2 p.m., in room SD-538 of the Dirksen Senate Office Building, Senator Donald W. Riegle, Jr. (chairman of the committee) presiding.

Present: Senators Riegle, Garn, D'Amato, Shelby, and Graham.

## OPENING STATEMENT OF CHAIRMAN RIEGLE

The CHAIRMAN. The committee will come to order. Let me welcome all of those in attendance this afternoon. This afternoon, the committee will consider the Lender Liability Act of 1990, which has been introduced by my colleague, Senator Garn, as part of his bill, S. 2827.

This legislation addresses certain concerns within the lending industry, participants in the housing and real estate development industries and certain Federal agencies, most notably, the Resolution Trust Corporation and the Federal Deposit Insurance Corporation, that must liquidate real estate assets and loans secured by such assets in performance of their deposit or loan insurance programs.

These concerns arise from laws that impose strict or no fault liability for the handling, disposal and clean-up of hazardous substances. Commercial banks and other lenders may assume the risk of incurring such liability if they secure their loans with collateral that becomes the site for disposal of hazardous substances.

The Federal statute that imposes no fault liability is the Comprehensive Environmental Response Compensation and Liability Act of 1980, as amended, commonly known as the Superfund.

The majority of the States and certain local governments have adopted statutes similarly imposing strict liability for hazardous substance disposal and contamination.

I first want to commend Senator Garn for seeking a discussion of the issues that were raised by the risks of liability that lenders and other parties must consider prior to lending on the security of or acquiring collateral that may become contaminated by hazardous substances. The risks are real and, if realized, could have a very significant financial impact upon lenders and Federal agencies that insure either deposits or loans.

For that reason, I am very happy to respond as we are doing today to Senator Garn's request for this hearing.

I might just say, Senator Garn, that in my travels in Michigan, I have run into this problem in any number of cases that come up about people who either wanted to take a pre-developed piece of land or to use a site, seek a loan on a site, and also from financial institutions that are backing away from that activity.

Second, I believe these issues need to be addressed within the larger context of the consideration of how environmental conditions and the complex web of Federal, State and local laws regulating such conditions affect the credit risks that federally insured depository institutions and other lenders may assume.

I want to know, for example, one, what the various environmental risks are that lenders must consider.

Two, how lenders are responding to those risks.

Three, what the potential risks of laws are to the Federal Government that are attributable to these environmental risks and lenders' responses to them.

We're going to begin today after our opening comments with the remarks of our good friend and distinguished House colleague, Congressman John LaFalce, chairman of the House Committee on Small Business, who has been, himself, instrumental in focusing the attention of the House of Representatives on the issues surrounding lender liability.

We will then proceed to hear two panels, the first composed of witnesses from the FDIC and the Environmental Protection Agency, and the second including witnesses from the American Bankers Association and the Environmental Defense Fund.

In selecting members of the panels, we have sought a balance of viewpoint that included adequate representation of both the environmental and lending communities.

With that, I want to also state before calling on Senator Garn and then introducing our House colleague that I must attend another matter a little bit later this afternoon. So, in the spirit of bipartisanship, which we use on this committee in all matters, I will ask Senator Garn to chair this hearing in my absence should there not be anyone else here at any particular time.

With that, Senator Garn, let me call on you for your statement.

## OPENING STATEMENT OF SENATOR GARN

Senator GARN. Thank you very much, Mr. Chairman. If you are gone and there are no Democrats here, I have had experience at chairing this committee. [Laughter.]

The CHAIRMAN. There are probably several bills that might go through here on unanimous consent. [Laughter.]

Senator GARN. Mr. Chairman, I want to begin by thanking you for holding this hearing today to look into the issue of growing concern of the financial services industry and the regulatory agencies, whose welfare is the chief responsibility of this committee.

The issue to which I am referring is the prospective liability of having to pay a huge environmental clean-up cost for property pollution that neither the lending institutions nor the regulatory agencies were responsible for causing.

The imposition of this liability without regard to fault has the potential to undermine the financial condition of lenders, and even

the financial viability of the Federal Deposit Insurance Fund. It has affected credit availability for many sectors of our economy.

Such a liability could vastly increase the already immense costs facing the Resolution Trust Corporation. The Lender Liability Act of 1990, which I introduced for discussion purposes as part of S. 2827, was directed at resolving this problem while protecting the lender's proper role in promoting a cleaner environment.

As I noted when introducing my first bill on these issues back in March, just last year, Congress passed landmark legislation designed to place the Federal Deposit Insurance Funds on a sound footing and to help ensure the health of our financial institutions going forward.

Attainment of those important goals may be impeded if liability for environmental hazards is imposed on the Resolution Trust Corporation. Various deposit insurance funds or the lenders themselves, merely because they foreclose on property or act as fiduciaries for property containing hazardous wastes.

Most recently, the Court of Appeals in the so-called *Fleet Factors* case extended potential liability to lenders who worked with borrowers to avoid default on loans collateralized by contaminated property even when they have absolutely no involvement in the environmental problem.

Earlier today, I received a statement from the RTC supporting this legislation as a constructive step and concluding that if the RTC is not successful in avoiding environmental liabilities, the very resources dedicated by Congress to the rescue of savings and loans could be imperiled.

Moreover, as my colleagues on this committee are well aware, the stresses on our financial system did not end when we passed the 1989 legislation. We must continue to take whatever steps are necessary and appropriate to protect the health of our financial institutions and to prevent the cost of resolving the S&L problems from growing even larger than their already astronomical figures.

S. 2827 would limit the potential liability of the banking agencies and the RTC for costs that otherwise might be imposed on them under certain environmental laws, such as the Superfund Act for cleaning up property that they acquired in the exercise of their supervisory or assistance authority.

The bill would also exempt insured depository institutions and certain other lending institutions from clean-up liability that might be imposed merely because they foreclosed, acted as fiduciaries or worked with borrowers to avoid default.

Mr. Chairman, the exemptions set forth in S. 2827 would not apply if the agencies or the lenders caused the problem or knew that the hazardous wastes were on the property and failed to take reasonable actions to prevent release.

The exemptions would not allow the lenders to derive any actual benefits from a clean-up financed by EPA or another party. And I want to emphasize, if somebody is responsible and they knew about it and didn't do anything about it, there are no exemptions. I have no intentions of trying in any way where people are culpable to get them off by any exemptions.

But, the examples over and over again, and I would cite just one, a bank in my own State, financed an automobile dealership more

than 15 years ago. It was an unpolluted piece of property. They built a new automobile agency on it. Fifteen years later, they foreclosed.

Again, I emphasize it was a new facility. There certainly was no pollution there. They foreclosed. What happens is they find that the ground is contaminated. A new dealer takes over, refuses to buy the building. He buys the franchise, the inventory and all of that and moves to a different location, and the bank ends up with a piece of property that's not worth nearly as much as the cleanup costs.

Now, that simply isn't fair. It just simply isn't fair. And to impose that, I can give you dozens of examples of that kind. If they had known, if they had financed a polluted piece of property and knew it was there and did nothing about it, that's a different story.

So I want to emphasize what my bill is trying to do. Only to take care of those who have no knowledge, did not participate and only because they foreclosed, in bankruptcy type situations, or acted as fiduciaries, as I've said, it isn't fair to add to their burden or add to the crisis of the financial institutions of this country.

I do not believe that lenders should be able to ignore environmental risks when deciding whether to make a loan. And under this bill, they could not ignore such considerations. Safe and sound lending would dictate this inquiry, given the potential impact of an adverse judgment on both the borrower's ability to repay a loan and the value of collateral, all lenders covered by the bill would be subject to the Environmental Due Diligence requirements of their regulators.

These requirements serve not only to enhance safety and soundness but also to minimize the hazardous waste sites of tomorrow by promoting prudent lending and lender involvement rather than discouraging involvement altogether.

In conclusion, I believe that because of the potential consequences for our financial system, for the continued growth of our economy, it is vitally important that this committee be fully aware of the risks posed by environmental liability to consider possible legislation to limit the potential damage.

Our witnesses today will present a balanced and expert view on these important issues. I welcome and look forward to their testimony.

Mr. Chairman, I would also ask unanimous consent that the statements of the Resolution Trust Corporation, the Miners Bank of Butte, Butte, MT, the International Council of Shopping Centers and the IVAA, as well as an editorial from the Chicago Tribune, be included in the record.

The CHAIRMAN. Without objection, they will be.

[Copy of proposed bill S. 2827 follows:]

II

101ST CONGRESS
2D SESSION

# S. 2827

To improve the administration of the Federal Deposit Insurance Corporation and to make technical amendments to the Federal Deposit Insurance Act.

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IN THE SENATE OF THE UNITED STATES

JUNE 28 (legislative day, JUNE 11), 1990

Mr. GARN introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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# A BILL

To improve the administration of the Federal Deposit Insurance Corporation and to make technical amendments to the Federal Deposit Insurance Act.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

## TITLE I—AMENDMENTS TO FEDERAL DEPOSIT INSURANCE ACT

## Subtitle A—Improvements

**SECTION 1. SHORT TITLE.**

This subtitle may be cited as the "Federal Deposit Improvements Act of 1990".

★(Star Print)

SEC. 1001. TERMS OF OFFICE.

Section 2(c) of the Federal Deposit Insurance Act (12 U.S.C. 1812) is amended to read as follows:

"(c) TERMS.—

"(1) APPOINTED MEMBERS.—Each appointed member shall be appointed for a term of 6 years.

"(2) INTERIM APPOINTMENTS.—Any member appointed to fill a vacancy occurring two or more years before the expiration of the term for which such member's predecessor was appointed shall be appointed only for the remainder of such term. Any member appointed to fill a vacancy occurring within 2 years of the expiration of the term for which such member's predecessor was appointed shall be appointed for a new term of 6 years.

"(3) CONTINUATION OF SERVICE.—The Chairperson, Vice Chairperson, and each appointed member may continue to serve after the expiration of the term of office to which such member was appointed until a successor has been appointed and qualified. This provision applies notwithstanding the date on which such member was initially appointed.".

SEC. 1002. CONVERSIONS.

Section 5(d)(2)(C) of the Federal Deposit Insurance Act is amended to read as follows:

"(C) APPROVAL DURING MORATORIUM.—The Corporation may approve a conversion transaction at any time if—

"(i) the conversion transaction affects an insubstantial portion, as determined by the Corporation, of the total deposits of each depository institution acquired as part of such conversion transaction;

"(ii) the conversion occurs in connection with the acquisition of a Savings Association Insurance Fund member in default or in danger of default, and the Corporation determines that the estimated financial benefits to the Savings Association Insurance Fund or Resolution Trust Corporation equal or exceed the Corporation's estimate of the loss of assessment income to such insurance fund over the remaining balance of the 5-year period referred to in subparagraph (A), and the Resolution Trust Corporation concurs in the Corporation's determination; or

"(iii) the conversion occurs in connection with the acquisition of a Bank Insurance Fund member in default or in danger of default and the Corporation determines that the estimated financial benefits to the Bank Insurance Fund equal or

exceed the Corporation's estimate of loss of assessment income to the insurance fund over the remaining balance of the 5-year period referred to in subparagraph (A).".

**SEC. 1003. TEMPORARY SUSPENSION OF DEPOSIT INSURANCE.**

Section 8(a)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1818(a)) is amended—

(1) by amending subparagraph (A) to read as follows:

"(A) IN GENERAL.—If, the Board of Directors, after consultation with the appropriate Federal banking agency, finds that an insured depository institution (other than a savings association to which subparagraph (B) applies) has no tangible capital under the capital guidelines or regulations of the appropriate Federal banking agency, the Corporation may issue a temporary order suspending deposit insurance on all deposits received by the institution."; and

(2) by amending subparagraph (C) to read as follows:

"(C) EFFECTIVE PERIOD OF TEMPORARY ORDER.—Any order issued under subparagraph (A) shall become effective not earlier than 10 days from the date of service upon the institution and,

unless set aside, limited, or suspended by a court in a proceeding authorized hereunder, shall remain effective until an order of the Board under paragraph (3) becomes final or until the Corporation otherwise dismisses or sets aside the order.".

**SEC. 1004. PRIORITY OF CLAIMS.**

Section 11 of the Federal Deposit Insurance Act is amended by adding at the end thereof the following:

"(p) PRIORITY OF CERTAIN CLAIMS.—In any proceeding relating to a claim acquired under this section or section 13 against an insured depository institution's director, officer, employee, agent, attorney, accountant, appraiser, or any other person employed by or providing services to an insured depository institution, any suit, claim, or cause of action brought by the Corporation shall have priority over any other suit, claim, or cause of action asserted by depositors, creditors, or shareholders of the depository institution, except for claims of Federal agencies brought pursuant to section 6321 of the Internal Revenue Code or section 3713 of title 31, United States Code. This priority shall apply to both the prosecution of any claim and to the execution of any subsequent judgments resulting from such action.

**SEC. 1005. REMUNERATION.**

Section 18(b) of the Federal Deposit Insurance Act is amended by inserting "(1)" immediately before the first sentence, and adding the following new paragraph (2) as follows:

"(2) The Corporation may, by regulation or order, reduce or limit the remuneration to be paid by an insured institution, either directly or indirectly, to any institution-affiliated party, if such remuneration, including all nonsalary components thereof, would not be in the best interests of the institution, its depositors or the Corporation's insurance funds, and would be received when the institution (A) is insolvent, or (B) has been placed in receivership or conservatorship, or (C) is a troubled institution as determined by the Corporation by regulation. For purposes of this paragraph, the term "remuneration" includes deferred benefit arrangements and other compensation plans payable after the separation of the institution-affiliated party.".

**SEC. 1006. REPEALER.**

Section 18(m) of the Federal Deposit Insurance Act (12 U.S.C. 1828) is amended by striking out paragraph (5).

**SEC. 1007. BAR TO PARTICIPATION.**

Section 19(a) of the Federal Deposit Insurance Act is amended to read as follows:

"(a) PROHIBITION.—Except with the prior written consent of the Corporation.—

"(1) any person who has been convicted of any criminal offense involving dishonesty or a breach of trust, or has entered a pretrial diversion or similar program in lieu of a trial with respect to such a crime, may not participate, directly or indirectly, in any manner in the conduct of the affairs of an insured depository institution; and".

**SEC. 1008. DISCLOSURE OF UNINSURED STATUS.**

Section 28(h) of the Federal Deposit Insurance Act is amended to read as follows:

"(h) DISCLOSURES BY UNINSURED DEPOSITORY INSTITUTIONS.—

"(1) IN GENERAL.—Any depository institution the deposits of which are not insured by the Corporation shall disclose clearly and conspicuously in periodic statements of account and in all advertising that the institution's deposits are not 'federally insured'.

"(2) MANNER AND CONTENT.—The Corporation may, by regulation or order prescribe the manner and content of the disclosures required by paragraph.

"(3) ENFORCEMENT.—Compliance with the requirements of this subsection, and any regulation prescribed or order issued under this subsection, shall be enforced under section 8 in the same manner and to

the same extent as if the depository institution were an insured State nonmember bank.".

## Subtitle B—Limitation on Liability for Nonculpable Activities

**SEC. 1101. SHORT TITLE.**

This subtitle may be cited as the "Lender Liability Act of 1990".

**SEC. 1102. LIABILITY.**

The Federal Deposit Insurance Act is amended by adding at the end the following new section:

**"SEC. 35. EXEMPTION FROM LIABILITY FOR NONCULPABLE ACTIVITIES.**

"(a) DEFINITIONS.—For the purposes of this section:

"(1) The term 'property acquired through foreclosure' means property acquired by a depository institution or mortgage lender—

"(A) through purchase at sales under judgment or decree, power of sale, or from a trustee, if such property was security for an extension of credit previously contracted; or

"(B) through conveyance pursuant to an extension of credit previously contracted.

"(2) The term 'mortgage lender' means a person who is regularly engaged in the business of making extensions of credit secured, in whole or in part, by real

property to nonaffiliated parties, and complies with requirements imposed under subsection (e).

"(3) The term 'fiduciary capacity' includes acting as trustee, executor, administrator, custodian, guardian of estates, receiver, conservator, committee of estates of lunatics, or any other fiduciary capacity for the benefit of another.

"(4) The term 'extension of credit' includes lease transactions that are functionally equivalent to a secured loan and that are authorized by and comply with regulations issued by the appropriate Federal banking agency or State banking authority.

"(5) The term 'insured depository institution' shall include—

"(A) an insured credit union; and

"(B) a leasing company that is an affiliate of an insured depository institution.

"(b) EXEMPTIONS.—No insured depository institution or mortgage lender shall be liable under any law imposing strict liability for the release, threatened release, storage or disposal of a hazardous substance or similar material from property—

"(1) acquired through foreclosure;

"(2) held in a fiduciary capacity; or

"(3) held, controlled or managed pursuant to the terms of an extension of credit.

"(c) EXCLUSION.—The exemptions provided under (b) shall not apply to any person—

"(1) that has caused the release or threatened release or disposal of a hazardous substance or similar material from property described in subsection (b) that gives rise to a removal, remedial, or similar action;

"(2) with actual knowledge that a hazardous substance or similar material is used, stored, or located on property described in subsection (b), failed to take all reasonable actions necessary to prevent the release or disposal of such substance; or

"(3) that has benefited from removal, remedial or other response action, but only to the extent of the actual benefit conferred by such action on that person.

"(d) AGENCY IMMUNITY.—Neither the Corporation, the Resolution Trust Corporation, the Board of Governors of the Federal Reserve System, and any Federal Reserve Bank, the Federal Housing Finance Board and any Federal Home Loan Bank, the Comptroller of the Currency, the Office of Thrift Supervision, the National Credit Union Administration, nor the Farm Credit Administration in any of their capacities shall be liable under any law imposing strict liability for the release, threatened release, use, storage, or disposal

of a hazardous substance or similar material from property acquired—

"(1) in connection with the exercise of receivership or conservatorship authority or the liquidation or winding up of the affairs of an insured depository institution;

"(2) in connection with the provision of loans, discounts, advances, or other financial assistance; or

"(3) in connection with property received in connection with any criminal, enforcement, or other civil proceeding, whether by settlement, order, or otherwise.

The immunity provided herein to the entities designated in this subsection shall not apply if such entity:

"(A) has caused the release, or threatened release of a hazardous or potentially dangerous substance; or

"(B) had actual knowledge that a hazardous or substance or similar material was located on such property but failed to take all reasonable actions necessary to prevent the release of such substance.

"(e) RISK ASSESSMENT.—Each appropriate Federal banking agency and the National Credit Union Administration Board shall take necessary actions to assure that depository institutions develop and implement adequate procedures to evaluate potential environmental risks that may arise from or at property or operations subject to their lending and fidu-

ciary activities. The Secretary of the Department of Housing and Urban Development shall promulgate guidelines to assure that mortgage lenders develop and implement equivalent procedures to evaluate potential environmental risks that may arise from or at property or operations subject to their lending activities.".

# TITLE II—CLARIFYING AMENDMENTS TO THE FEDERAL DEPOSIT INSURANCE ACT

## SEC. 2001. INDEMNIFICATION.

Section 8 of the Federal Deposit Insurance Act is amended by adding at the end thereof the following:

"(v) No insured depository institution shall pay, reimburse, indemnify, or otherwise compensate any director or officer or other institution-affiliated person for fees, penalties, expenses, or other costs related to successful suits, claims, and civil and enforcement actions brought by the Corporation or the appropriate Federal banking agency against such institution-affiliated persons. Nothing in this subsection shall prevent an insured depository institution from purchasing directors' and officers' liability or similar insurance.".

## SEC. 2002. FSLIC RESOLUTION FUND.

Section 11A(a) of the Federal Deposit Insurance Act is amended to read as follows:

"SEC. 11A. FSLIC RESOLUTION FUND.

"(a) ESTABLISHED.—

"(1) IN GENERAL.—There is established a separate fund to be designated as the FSLIC Resolution Fund which shall be managed by the Corporation and separately maintained and not commingled.

"(2) HEADING.—Transfer of FSLIC Assets and Liabilities.

"(A) IN GENERAL.—Except as provided in section 21A of the Federal Home Loan Bank Act, all assets and liabilities of the Federal Savings and Loan Insurance Corporation on the date before the date of enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 shall be transferred to the FSLIC Resolution Fund.

"(B) ADDITIONAL CLAIMS ON ASSETS.—The FSLIC Resolution Fund shall pay to the Savings Association Insurance Fund such amounts as are needed for administrative and supervisory expenses from the date of enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 through September 30, 1991.

"(3) SEPARATE HOLDING.—Assets and liabilities transferred to the FSLIC Resolution Fund shall be the

assets and liabilities of the Fund and not of the Corporation and shall not be consolidated with the assets and liabilities of the Bank Insurance Fund, or the Corporation for accounting, reporting, or any other purpose.

"(4) USE OF FDIC POWERS.—As of August 10, 1989, the Corporation shall have the same powers and rights to carry out its duties with respect to the assets and liabilities of the FSLIC Resolution Fund as the Corporation otherwise has under this Act.

"(5) CORPORATION AS RECEIVER.—As of August 10, 1989, the Corporation shall succeed the Federal Savings and Loan Insurance Corporation as conservator or receiver with respect to any institution for which the Federal Savings and Loan Insurance Corporation was appointed conservator or receiver on or before December 31, 1988.

**SEC. 2003. BRANCHING.**

Section 13(k)(4) of the Federal Deposit Insurance Act (12 U.S.C. 1823) is amended to read as follows:

"(4) BRANCHING PROVISIONS.—

"(A) IN GENERAL.—If a merger, consolidation, transfer, or acquisition under this subsection involves a savings association eligible for assistance and a bank or bank holding company, the resulting entity may retain and operate any existing

branch or branches or any other existing facilities. If the savings association continues to exist as a separate entity, it may establish and operate new branches to the same extent as any savings association that is not affiliated with a bank holding company and the home office of which is located in the same State.

"(B) Restrictions.—

"(i) In general.—Notwithstanding subparagraph (A), if—

"(I) a savings association described in such subparagraph does not have its home office in the State of the bank holding company bank subsidiary, and

"(II) such association does not qualify as a domestic building and loan association under section 7701(a)(19) of the Internal Revenue Code of 1986, or does not meet the asset composition test imposed by subparagraph (C) of that section on institutions seeking so to qualify,

such savings association shall be subject to the conditions upon which a bank may retain, operate, and establish branches in the

State in which the Savings Association Insurance Fund member is located.".

**SEC. 2004. REMOVAL.**

Section 21A(l) of the Federal Home Loan Bank Act is amended to read as follows:

"(l) POWER TO REMOVE; JURISDICTION.—

"(1) IN GENERAL.—Notwithstanding any other provision of law, any civil action, suit, or proceeding to which the Corporation, in any capacity, is a party shall be deemed to arise under the law of the United States, and the United States district courts shall have original jurisdiction over such action, suit, or proceeding. The Corporation, in any capacity, shall be an agency of the United States for the purpose of section 1345 of title 28, without regard to whether the Corporation commences the action.

"(2) CORPORATION AS PARTY.—The Corporation shall be substituted as a party in any civil action, suit, or proceeding to which its predecessor in interest was a party with respect to institutions which are subject to management agreement dated February 7, 1989, among the Federal Savings and Loan Insurance Corporation, the Federal Home Loan Bank Board and the Federal Deposit Insurance Corporation. The Corporation shall be deemed substituted in any action suit or

proceeding for a party upon the filing of a copy of the order appointing the Corporation as conservator or receiver for that party or the filing of such other pleading informing the court that the Corporation has been appointed as conservator or receiver for such party.

"(3) REMOVAL AND REMAND.—The Corporation may, without bond or security, remove any action, suit, or proceeding from a State court to the appropriate United States District Court, including the United States District Court for the District of Columbia. The removal of any action, suit, or proceeding shall be instituted (A) not later than 90 days after the date the Corporation is substituted as a party, or (B) not later than 30 days after service on the Corporation, if the Corporation is named as a party. The Corporation may appeal any order of remand entered by a United States district Court.".

## TITLE III—CLERICAL AMENDMENTS TO THE FEDERAL DEPOSIT INSURANCE ACT

**SEC. 3001. TECHNICAL AMENDMENTS.**

(a) Section 3(q)(2)(E) of the Federal Deposit Insurance Act is amended by striking the word "Depository" and inserting in lieu thereof "Financial".

(b) Section 5(d)(3)(B) of the Federal Deposit Insurance Act is amended by striking the word "shall" in clauses (ii) and (iii).

(c) Section 5(e)(4) is amended by striking the designations "(i)" and "(ii)" and inserting the designations "(A)" and "(B)" respectively.

(d) Section 7(a)(8) of the Federal Deposit Insurance Act is amended by striking the phrase "the the" and inserting in lieu thereof "the".

(e) Section 7(l)(7) of the Federal Deposit Insurance Act is amended by striking the phrase "the value of".

(f) Section 7(m)(5) of the Federal Deposit Insurance Act is amended by striking the word "institution" the second time it appears.

(g) Section 8(a)(7) of the Federal Deposit Insurance Act is amended by striking the phrase "the period" the first time it appears.

(h) Section 8(b)(4) of the Federal Deposit Insurance Act is amended by striking the phrase "subsections (c), (d), (h), (i), (k), (l), (m), and (n) of this subsection" and inserting in lieu thereof "subsections (c) through (s) and subsection (u)".

(i) Section 8(b)(6)(F) of the Federal Deposit Insurance Act is amended by inserting the word "appropriate" immediately before the word "banking".

(j) Section 8(c)(2) of the Federal Deposit Insurance Act is amended by striking the word "injuction" and inserting in lieu thereof the word "injunction".

(k) Section 8(g)(1) of the Federal Deposit Insurance Act is amended by striking the comma immediately after the word "party" the first time it appears.

(l) Section 8(g)(2) of the Federal Deposit Insurance Act is amended by striking the phrase "depository institution" each time it appears and inserting in lieu thereof the word "bank".

(m) Section 8(o) of the Federal Deposit Insurance Act is amended by striking the phrase "board of directors" each time it appears in the second sentence, and inserting in lieu thereof the phrase "Board of Directors".

(n) Section 8(r) of the Federal Deposit Insurance Act is amended by striking the word "therof" and inserting in its place the word "thereof".

(o) Section 10(e) of the Federal Deposit Insurance Act is amended by redesignating it as section "(d)".

(p) Section 11(a) of the Federal Deposit Insurance Act is amended by striking the designation "(b)" the first time it appears and inserting in lieu thereof the designation "(B)".

(q) Section 11(c)(6)(B) of the Federal Deposit Insurance Act is amended by striking the word "Owner's" and inserting in lieu thereof the word "Owners' ".

(r) Section 11(d)(2)(B) is amended in clause (iii) by striking the word "is" and inserting in lieu thereof the word "are".

(s) Section 11(d)(8)(B) is amended in clause (ii) by inserting after "disallowed," the word "provide".

(t) Section 11(d)(16)(B) is amended in clause (iv) by striking the word "dispositions" and inserting in lieu thereof the word "disposition".

(u) Section 11(e)(12)(B) is amended by striking the phrase "directors or officers" and inserting in lieu thereof the phrase "directors' or officers'".

(v) Section 11(i)(3)(A) is amended by striking the word "or" the last time it appears in the second sentence and inserting in lieu thereof the word "of".

(w) Section 13(f)(6)(A) of the Federal Deposit Insurance Act is amended by striking the word "has" and inserting in lieu thereof the word "is".

(x) Section 13(i)(1)(A) of the Federal Deposit Insurance Act is amended by striking the word "corporation" the first time it appears and inserting in lieu thereof the word "Corporation".

(y) Section 13(i) of the Federal Deposit Insurance Act is amended by redesignating paragraph (11) as paragraph (10), and paragraph (13) as paragraph (11).

(z) Section 30(e) of the Federal Deposit Insurance Act is amended by striking the word "venders" and inserting in lieu thereof the word "vendors".

(aa) Section 31(b) of the Federal Deposit Insurance Act is amended by striking the phrase "Board of Directors" and inserting in lieu thereof the phrase "board of directors".

(bb) Section 34(a)(1)(A) of the Federal Deposit Insurance Act is amended in clause (iii) by striking the word "and" and inserting in lieu thereof the word "or".

The CHAIRMAN. Let me just say to our colleague from the House: Was that an indication that a vote is starting?

Representative LAFALCE. That is an indication, Mr. Chairman, that I have 10 minutes remaining in order to cast a vote. However, there are many duties we have to perform as Members of Congress. One is voting, and another is testifying for legislation. And my legislation, this now is more important. I will remain in this hearing room.

The CHAIRMAN. That's always a tough choice and we respect your view on it.

Representative LAFALCE. It depends upon the vote, of course. [Laughter.]

This is a relatively noncontroversial vote, and it will be a lopsided result. I want the record to reveal at least that's my present judgment. [Laughter.]

The CHAIRMAN. Very well. If we get a frantic call from Tom Foley in about 9½ minutes and there's a one-vote margin, we may have to excuse you in a hurry.

Representative LAFALCE. This is not a balanced budget amendment.

The CHAIRMAN. Let me just take note of H.R. 4494, which is the legislation you've introduced and say again you have taken a leadership role in this area, one of many, I might say. So we are very pleased to have you come over and give us your thoughts today.

We would like to hear those now.

## STATEMENT OF JOHN LaFALCE, MEMBER IN CONGRESS OF THE U.S. HOUSE OF REPRESENTATIVES, CHAIRMAN OF THE COMMITTEE ON SMALL BUSINESS, FROM THE STATE OF NEW YORK

Representative LAFALCE. Thank you very much, Mr. Chairman, Senator Garn. It's a pleasure for me to be here. I would like unanimous consent to have the entire text of my statement inserted in the record.

The CHAIRMAN. Without objection.

Representative LAFALCE. I will not summarize but give my own verbal testimony.

First of all, let me commend Senator Garn for introducing his own legislation, which differ in some significant respects from mine. I have no particular pride of authorship. I would be delighted if Senator Garn's bill became the law of the land. I would be delighted if Congressman Tom Luken or Congressman John Dingell's bill became the law of the land.

I have one objective and one objective only, and that's to solve a very real problem in the United States of America.

At this juncture, I would point out though that I now do have 263 Members of the House of Representatives who have cosponsored my particular bill. I hope this will be an impetus to both the House Energy and Commerce Committee, which has legislative jurisdiction, and the Senate, to produce action on some bill in this Congress, and not to put it over until the next Congress.

Senator GARN. John, if I could interrupt on that point, I would agree with you. My pride of authorship is not nearly as important

as Congress fashioning a bill that we can agree on to help solve this problem.

Representative LaFalce. If I'm unsuccessful in the Energy and Commerce Committee, I'll attach your bill to some other bill that's coming down the pike and we can go to conference on it. And then that's great, too, however we can slice it.

Let me begin at the beginning. For me, the beginning is the year 1977. I received a phone call from a constituent. The constituent said:

> Congressman, I've got a problem in my basement. I've got a problem in my backyard, and you're my Congressman and I want you to come out here and help me with my problem.

Well, I was a young Congressman in those days and I did things like that.

I went to her backyard and I went to her basement and I didn't know what exactly I was seeing, and I didn't know what exactly I was smelling. But I knew Trouble with a capital T. I smelled Trouble with a capital T.

So, I called up the New York State Department of Environmental Conservation and the New York State Department of Health and the Environmental Protection Agency, the Regional Administrator in New York City at the time, and the National Institute for Environmental Health Sciences, et cetera. And I said: Come here to my district and smell what I've smelled and see what I've seen.

And they did. And a year later, the world knew the Love Canal. I began grappling with the problem of how to deal with the problem of abandoned hazardous waste sites from that time forward.

I quickly discovered there was no easy way because there was no comprehensive legislative framework to deal with such problems. We had a dozen different laws on the books. We could deal with oil spills. We could deal with polluted sites. We had RCRA, we had the toxic substances legislation, et cetera, but we didn't have something that could deal with abandoned hazardous waste sites.

What does any good Congressman do when he sees a problem? He says, "There ought to be a law."

And he introduces a bill. And I introduced a bill, along with Senator Pat Moynihan, the first Superfund bill introduced in the U.S. Congress.

I'm not going to say that that is the bill that became the law of the land because, subsequent to that, there were many follow-up versions of Superfund.

It took years but, finally, in the office of Senator Howard Baker in December 1980, we produced a law that we now refer to as Superfund.

There were many controversial issues we had to deal with. None was more controversial than the issue of liability under Superfund. Who should be liable?

Now, clearly, we have Superfund. The Government is going to clean up these sites. But, who should the Government go against in the first instance, or who should the Government go against in the second instance, after they've acted?

Very controversial. Clearly, guilty parties, negligent parties, but what about others?

Well, we did make successive owners liable. That was controversial but we did it. But, there was no controversy about one issue. There was no controversy that we ought not make lenders liable merely by virtue of the fact that they had loaned money.

Now, if they had become involved in the problem in some way, that's different. And, of course, we also recognized in 1980 that lenders don't give money without some collateral.

And so we specifically exempted the security interests; if you take a security interest, you're exempt.

Now, we thought that was pretty clear for the world to see. For a number of years, it was. But, you know, funny things happen on the way to the forum sometimes, when you go before the courts. They interpret legislation sometimes not according to congressional intent, but in a manner designed to reach a certain result.

And, sometimes, it's the result of finding somebody with deep pockets. And so some courts have interpreted that security exemption to mean, well, you have an exemption if you have a security interest, but the minute you perfect that security interest, the minute you exercise your rights under that security interest, ipso facto, you lose the exemption.

In other words, the courts have said:

Congress intended to create this right but they just didn't want to give you a remedy to accompany the right.

That assumes that Congress deliberately intended to act irrationally.

Senator Garn, you and I know that, in 1980, we did not intend to act irrationally. We, in fact, did not act irrationally. The courts have misinterpreted what you and I and 533 others and the President of the United States intended.

That has had some very unintended consequences, which I will get into as chairman of the Small Business Committee very shortly, but it doesn't end there.

You see, if you are a trustee of some trust or an executor of some estate and there's some real property in that trust, there's some real property in that estate, ipso facto, by that very fact, you are then institutionally and personally liable under judicial decisions for the full cost of clean-up—not just the amount of the trust, not just the amount of the estate. The trust could be $100,000, the estate could be $100,000, and the cost of clean-up could be $2 million or $5 million. You are liable for the full cost of clean-up.

So you have an attorney now who is asked by some friends to be a trustee. And he says, "Wait a minute." Or, he's asked to be an executor. Is there any real property involved? Wait a minute now. I do not want to assume this personal liability.

He has another situation, too. We have dealt with the fiduciary situation. We have dealt with the security interest. But, what about just a simple financial transaction?

An institution gives money. Forget about the security interest. In a recent decision, 2 months or so ago, it's called the Fleet Factors case, a circuit court of appeals held—this is difficult to believe, but it's true.

Senator Shelby. Which circuit was it?

Representative LaFalce. The 11th circuit.

If a jury can infer that because of your loan to a business, you have the capacity to influence that business—"the capacity to influence"—I put that in quotes, then you may be held liable for the full cost of cleanup. Forget the security interest. Forget the perfection of that security interest. If a jury can infer that you have the capacity to influence because of the loan you gave, you are liable for the full cost of cleanup.

Now, this sends tremors through the lending community. Let me tell you how I got involved in this problem. It was 2 years ago. I got a phone call from the mayor of another city that I represent, Rochester, NY. Mayor Tom Ryan.

He said, "John," he said, "I've got a problem in Rochester, and you're just the boy to help me with it."

I say, "Oh, what's the problem and why am I just the boy to help you with it?"

He says, "Because it involves both small businesses and banks and you're on the Small Business Committee. You're the chairman of it. And you're on the Banking Committee."

And I said, "What's the problem?"

He said, "I've got a section of an industrial park. There are about 112 businesses there. And they can't get a dime from these banks."

And I said, "Well, you know these banks."

He says, "Yeah, they'll give you an umbrella for a rainy day, but not if it's raining. Not if you need it."

I said, "Let me talk to them."

So I talked to these banks. And all I got from them: "Well, we just can't do it."

The ones I was talking with really didn't know the reason they couldn't do it, they just knew that, in this industrial park, they couldn't give loans.

I said, "Well, let me talk to the SBA." This is a situation where the SBA can come in and say, well, for whatever reason, we'll guarantee it. These are good businesses.

And then the general counsel to the SBA produces a memorandum to me, a legal memorandum, which then spells out these judicial interpretations which would hold the SBA liable if the SBA is a guarantor of property and this property has to be cleaned up.

What's happening? What's happening is you have all businesses, but certain businesses in particular, gasoline service station operators. They can't get any money. You have print shops, cleaning shops, farmers, who are dealing with toxic substances all the time.

There's a problem, too, if you go in a rural community where you have one gasoline station and you have one of everything, including one bank. It's a small little bank and you talk about $100,000 or $200,000 loans, the bank might be able to do it. It's a big loan for that particular bank, it's a big loan for that particular company.

But, you talk about potential liability of $2–5 million.

Somebody came in to see me on Tuesday in California, who got a $50,000 loan and is now being assessed a $2 million cost of cleanup. It's a real story I'm talking about. This is not make-believe. This is not fiction. It's real.

What happens to a bank? It's wiped out of existence if that's the bank with the $50,000 loan.

Forget the banks. The banks are going to protect themselves somehow. They're just not going to give these loans out; when there's even the slightest, remotest possibility, the crunch is on the small business community. And we're going through a, quote, "crunch" right now. It's a credit crunch. It's caused by a whole slew of reasons. It's caused by the S&L's. It's caused by the economy. It's caused by the new stringency on the part of the regulators.

But, it's also caused by actions such as this, by judicial interpretations such as this, which have sent shock-waves through the financial community, and which has its impact primarily on the small business community.

I am as environmentally conscious as any Member of this Congress. I do not want to enact any legislation that's going to have some adverse impact on the environment. But, we have to be reasonable in all things.

And the judicial interpretations have produced an unreasonable, very, very harmful result. That's why we've been able to get 263 Members of the House to cosponsor my bill. That's why we need action in both the House and the Senate. And that's why we need action in this session of this Congress rather than wait until Superfund is up for reauthorization, because if we wait until Superfund is up for reauthorization, this discrete and important issue will get caught up with 1,000 other issues and might not be dealt with for as long a period of time as it took us to come up with the reauthorization of the Clean Air Act. And we can't do that.

We have to deal with this issue discretely and now.

Thank you.

[The complete prepared statement of John J. LaFalce follows:]

TESTIMONY OF JOHN J. LAFALCE, CHAIRMAN OF THE HOUSE OF REPRESENTATIVES COMMITTEE ON SMALL BUSINESS, JULY 19, 1990

Mr. Chairman, I am very pleased to testify before your Committee on environmental lender liability. As you know, I have introduced legislation in the House, H.R. 4494, which would exempt lenders from liability when they merely foreclose on contaminated property. As of today, well over half the House, 260 members, have signed on as cosponsors.

My involvement with the issue of hazardous waste cleanup extends back to my earliest days in Congress in the mid-1970s, because some of the most severe hazardous waste problems in the country have occurred in my district and in other parts of Western New York. I am thinking in particular of the Love Canal episode.

In fact, it was Love Canal, more than any other single event, that brought the nation's attention to the fact that no federal mechanism existed for remediation of such a disaster, and that led ultimately to tha enactment of Superfund. I introduced the first Superfund bill, and from the start I have been a supporter of strong Superfund legislation. I think that, in enacting Superfund, Congress did a good job of balancing environmental interests against other interests. That is why I

find it so disturbing that courts have in recent years expanded Superfund liability far beyond what Congress ever intended and created a severe and growing problem for thousands of credit-worthy small businessas and their lenders across the country.

My current involvement with the issue of environmental lender liability extends from last year, when it came to my attention, as Chairman of the Small Business Committee, that the primary impact of environmental lender liability is on the small business community. Over the past year, the Committee has held two hearings on the problems thet environmental lender liability poses for small businesses and their lenders. I think the hearing record establishes two things quite clearly. First, Congress, in enacting Superfund in 1980, never intended to hold lenders liable when they forecloee on contaminated property and that, therefore, recent court decisions holding such lenders liable stand in direct violation of Congressional intent. Second, the problsm created by these court decisions for the small business community is national in scope, affects a wide range of industries, and is growing. I will discuss these issues in turn.

With regard to Congressienal intent, I believe that in enacting Superfund in 1980, Congress did not intend to hold lenders liable unless they become involved in management of the borrower's facility. As you know, the Superfund statute creates

an express exemption from clean-up liability for a lender "who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility." This is known as the "security interest exemption." Congress clearly intended this exemption to apply not only when a lender holde a security interest, but also when it exercises its rights in that security interest by foreclosing on and taking title to the facility. The right of foreclosure, after all, is fundamental to secured credit. To construe this otherviee is to state that Congress intended to create a right without a remedy.

Despite the clear statutory language and intent, some recent federal court decisions have held that lenders are liable when they merely foreclose on contaminated property or have the capacity to influence the borrower's treatment of hazardous waste. In 1986, the federal district court of Maryland, in U.S. v. Maryland Bank & Trust, held that when Maryland Bank & Trust foreclosed on a farm which later was discovered to be contaminated with hazardous waste, the bank became an "owner" under Superfund and was thus liable for the cost of cleanup. The bank ended up settling the case with EPA for more than $400,000. In 1989, the federal district court for the Western District of Pennsylvania, in Guidice v. BFG Electoplating, held a bank liable when it merely foreclosed on its mortgage on a dsfunct electroplating plant and held title for 8 months before

reselling. Similarly, the president of a very small bank, the Miners' Bank of Butte, Montana, testified before my Committee last month that his bank now faces impairment, and possibly insolvency, because it foreclosed on a contaminated facility in 1984 and has been named by E.P.A. as a potentially responsible party. Cleanup costs in the Montana case are estimated at $7-10 million, which is nearly 20 times the size of tha original loan. I want to point out that in none of these cases did the lenders cause or contribute to the contamination or become involved in management of the borrower's facility. They were held liable merely by virtue of the fact that they foreclosed on property that turned out to be contaminated.

The most recent case, and perhaps tha most disturbing one, is U.S. v. Fleet Factors Corp., which came down two months ago in the Eleventh Circuit. The Circuit Court opinion held that a lender may be liable if it "participat[es] in the financial management of a facility to a degree indicating a capacity to influence the corporation's treatment of hazardous wastes. It is not necessary for the secured creditor actually to involve itself in the day-to-day operations of the facility in order to be liable." Notice how broad this language is. Under this legal standard -- "capacity to influence" -- no secured lender is safe, even a secured lender which does not foreclose, because it can be argued that anyone who makes a loan has the capacity to influence the borrower's treatment of hazardous waste.

This expansion of lender liability has raised another concern: that courts will now begin to expand liability to a trustee or executor which merely helds title to or control of a contaminated property as part of a trust or estate. It is possible that courts will interpret Superfund so that such a fiduciary will be liable for the cost of cleaning up tha contaminated property and for damages. Liability in a case like this could exceed the value of the entire trust or estate, in which case the fiduciary may be held personally liable.

Although some courts, searching for deep pockets to pay for Superfund clean-ups, have violated Congressional intent, I want to point out that other courts have been faithful to Congressional intent and have respected the security interest exemption. For example, in United States v. Mirabile, a 1985 federal case in the Eastern District of Pennsylvania, the court dismiosed the case against a lender which had restricted its participation in the borrower's affairs to general financial matters and avoided "the nuts and bolts day-to-day production aspects of the business." This stands in contrast to Fleet Factors, where mere "capacity to influence" determined liability. To cite another example, in a 1988 lender liability case in the Southern District of Texas, Coastal Casting Service, Inc. v. Aron, the court made clear in its opinion that foreclosure on property was not enough to find the lender liable as an owner.

What is more, E.P.A. Administrator William Reilly told a briefing of business reporters on June 19 that it is not the intent of E.P.A. to "involve innocent bystanders and lenders in these liability cases." It is not the federal government's "intention", he said, to hold banks and other lenders liable for cleanup even if they own property contaminated with hazardous waste. Thus, Congress, in enacting Superfund, never intended such lenders to be liable; several courts have agreed that such lenders should not be liable; and now the head of the Environmental Protection Agency agrees these lenders should not be liable.

But it is the fact that some courts have held these lenders liable that has created the mess which brings us here today. What cases like *Maryland Bank & Trust* and *Fleet Factors* effectively mean, Mr. Chairman, is that a lender which makes a $50,000 secured loan could end up paying $5 million to clean up contamination which it did nothing to cause or create. In many cases, it is not worth it for the lender to take that risk. And so, what we are seeing across the country is that many lenders have stopped making secured loans to businesses that either use hazardous materials or are located in areas of possible hazardous waste contamination. The result is that thousands of well-run, credit-worthy small businesses which can offer only their facility or property as collateral cannot obtain the financing they need to survive.

I first became aware of this problem when it surfaced in my Congressional district in Western New York, at the Rochester Outer Loop Industrial Park. It is a large industrial park which has existed since the early 1970s. Recently, it was suspected that the land beneath the Park may be contaminated, since the site was used as a landfill before 1971. But recent investigations of the land by the New York State Department of Environmental Conservation failed to find evidence of serious contamination. Nevertheless, over the past several years the small businesses located within the Park have not been able to obtain financing from any lender, up to and including the state of New York and the Small Business Administration, because the lenders fear exactly what I have been talking about -- that a $50,000 loan could turn into a $5 million nightmare. Without financing, the businesses in the Park will not survive.

At our August 3rd hearing last year, the Petroleum Marketers of America testified that many of their members needed financing to repair and replace their underground petroleum storage tanks in order to comply with E.P.A. regulations. But they could not get that financing because lenders were afraid of liability under Superfund and under the Resource Conservation and Recovery Act. In other words, these petroleum marketers could not even get the financing they needed to clean up their facilities. And so these independent petroleum marketers, most of which are small businesses, were faced with the imminent closure of over 25,000

servico stations across the country. What finally happened is that the E.P.A. agreed to postpone implementation of its regulations, rather than face the prospect of 25,000 service stations going under. What this case illustrates so clearly is that environmental lender liability is not only threatening the existence of tens of thousands of small businesses, it is also impeding efforts by responsible businesses to clean up their facilitias.

I have heard similar accounte from companies in other industries and geographical areas. Drycleaners, transshippers, electric platers, wood product manufacturers, metal finishers, and other businesses that use hasardous meterials either in their processes or as a part of the product often have difficulty obtaining a loan secured by their facilities. Farmers and agricultural businesses are also affected. As the National Farm Credit Council testified at our June 7th hearing:

> " . . . lenders' liability for environmental laws is choking off credit to credit-worthy applicants in situations where environmental problems are merely suspected and in cases where credit may be the only source of cleanup funds. Furthermore, many of these applicants are small businesses with limited access to credit."

The problem can be particularly acute in rural areas. A small banker from the rural town of Dana, Indiana testified before the Small Business Committee on June 7th that the recent court decisions on environmental liability could affect the bank's ability to finance the community's only auto body shop, its only convenience store and gas station, its two auto repair places, its one fuel dealer, and much of the farm land in the community. The witness explained that as the only bank in the community, it faces a double-edged sword: if it does not finance these businesses, most of which are family owned, the businesses will have to close down, and their properties could become worthless to them and anyone else; on the other hand, if the bank continues to finance these businesses and farms it might face an extremely costly environmental clean-up.

I should note that it is not just private lenders that are being forced to curtail their activities, it is government and quasi-government agencies, as well. The Small Business Administration, the Federal Deposit Insurance Corporation, Fannie Mae, Freddie Mac, the Resolution Trust Company, the Farmers Home Administration, and farm credit councils are all faced with potentially enormous liability for hazardous waste cleanup as a result of the recent court decisions, and, in many cases, have expressed an interest in legislation to that would shield them from unfair liability. As Chairman of the Small Business Committee, I was amazed to find that the Small Business

Administration iteslf has a policy of not making loans which create a risk of hazardous waste liability for the agency.

In the 1986 Superfund amendments, Congress created what is known as the "innocent landowner defense," which was intended to provide a way for secured lenders and others to protect themselves against liability. A defendant can avoid liability, according to the defense, if it can shew that before it acquired a facility, it undertook "all appropriate inquiries" to find contamination. The problem with the innocent landowner defense is that E.P.A.'s interpretation of that defense, and the court decisions which construe it, give lenders no clear guidence what steps they must take to avoid liability. Testimony before the Small Business Committee likened the search for an innocent landowner to Diogenes in the daylight with his lantern: if the lender undertook all appropriate inquiry, and the contamination was found, then the lender was not an innocent landowner. If the lender did not find the contamination, then all appropriate inquiry was not made. Environmental assessments do not and cannot provido complete assurance thet a piace of property is not contaminated. And that is why thare is a broad consensus in the lending community that the innocent landowner defense simply does not provide a safe harbor from liability.

To summarise, I believe that some courts have vitiated Congressional intent and created enormous problems for the small

business sector, problems which are just beginning to be felt. The lending community has not fully adapted to the new court decisions, but it will be forced to. The day has come when a lender which ignores these court decisions, and continues its current landing practices, is risking its very survival. As lenders continue to shut down their lending activities, we are going to ses an increasingly severe squeese on credit for what I regard as the most important sector of the American economy -- the small business sector. As Chairman of tha Small Business Committee, I have become acutsly awere that small businesses in this country have in recent montha been experiencing a credit crunch which is real and is spreading. While there are many causes for that squeeze on credit, environmental lender liability is surely a contributing factor.

Some people have said we should wait to resolve this problem until next year, when Superfund is up for reauthorization. We cannot wait. The small business community cannot wait. What we are seeing now is just the tip of the iceberg. Let us resolve this problen now -- this year -- before it grows to catastrophic proportions.

As to the specifice of my bill, I want to emphasize that I am net wedded to it in its precise form. I recognize that seme amendments may well be in order. I am sure that we can fashion a selution to this problem that can accommodato all legitimato

concerns. I would welcome any discussions toward that and. But the time to address this issue is now. Time is running out, not only for this session of Congress, but also for the small business community. Thank you.

Senator GARN [presiding]. John, thank you very much.

We appreciate your testimony. I'm very glad you saved me the necessity of pointing that out at the beginning. I think most people are aware of your long involvement in Superfund and your environmental credentials.

## OPENING STATEMENT OF SENATOR SHELBY

Senator SHELBY. John, I just want to tell you I enjoyed working with you when we were in the House together. When you come before this committee today, you're no stranger here. You brought with you a lot of sense, but a lot of common sense, which some of the courts need at times. And perhaps we need at times.

I want to commend you for your leadership in this area, in the House.

Also, I want to take this moment to commend my colleague, Senator Garn. I'm a cosponsor of his legislation. It makes sense. It's timely. We are in a credit crunch. You know, from sitting on the Banking Committee over on your side of the aisle, what's going on, and we know from here. Even our expert witnesses who have been before the panel the last several days know that.

So, this just compiles the problem. And if I were a bank, should they look after themselves? I hope so, the best they can. But what they're doing, they are aiding and abetting the credit crunch. And it's not their fault, for once.

And we need this legislation. I believe that we've got a chance to get it through. Congress is moving on. It just makes sense, and I want to commend you for it. You and Senator Garn.

Representative LAFALCE. Thank you very much, Senator.

One last point that either I didn't make or I didn't make adequately. I'm really not seeking some new law. I am seeking to reinstate the law as we envisioned it in 1980, as we thought we had made it clear, as some courts have interpreted it.

I want to restore the congressional intent that we thought we articulated fairly well in 1980. And, obviously, we could have done a better and clearer job.

Senator SHELBY. What's your timetable in the House?

Representative LAFALCE. Congressman Luken is going to have a hearing on the 2nd. To the extent that you can encourage him not only to have a hearing but to have a markup of some bill, whether it's mine, Senator Garn's or his own, then I'm the first to admit that mine could be improved upon. And I would welcome any reasonable suggestions.

By reasonable suggestion, I mean somebody who in good faith thinks there's a problem that needs legislative remedy rather than somebody who just wants to be obstructionist, saying: I don't care about anything other than environmental considerations and I don't care about business problems, I don't care about lending problems, I don't care about economic problems.

That type of individual who just wants to toss out phony, false scare tactic arguments. Forget it. If they have some legitimate considerations and concerns, I am more than willing to talk.

Senator SHELBY. This is one time, and I am sure that there are others, that the banks, in my opinion, have a real legitimate reason for being here in force.

I hope they will push on this.

[The complete prepared statement of Senator Shelby follows:]

Richard Shelby

STATEMENT BY SENATOR RICHARD SHELBY
AT HEARING ON LENDER LIABILITY
JULY 19, 1990

MR. CHAIRMAN, I COMMEND YOU FOR SCHEDULING THIS AFTERNOON'S HEARING ON A SUBJECT THAT HAS BECOME INCREASINGLY IMPORTANT. I WOULD LIKE TOO TO COMMEND SENATOR GARN FOR HIS LEADERSHIP IN THIS AREA. HE HAS IDENTIFIED AN ISSUE OF GREAT IMPORTANCE TO INSURED FINANCIAL INSTITUTIONS AND TO A GROWING RANGE OF BORROWERS, AS WELL AS TO THE REGULATORS AND ULTIMATELY TO THE TAXPAYER.

WHEN CONGRESS PASSED CERCLA (THE COMPREHENSIVE ENVIRONMENTAL RESPONSE, COMPENSATION, AND LIABILITY ACT OF 1980), BETTER KNOWN AS THE SUPERFUND ACT, IT WAS ITS INTENTION TO MAKE THOSE RESPONSIBLE FOR HAZARDOUS WASTE PAY FOR ITS CLEANUP. HOWEVER, RECENT COURT DECISIONS HAVE EXTENDED THE LIABILITY TO LENDERS, EVEN WHEN THAT LENDER DID NOT CONTRIBUTE TOWARD THE CONTAMINATION OF THE PROPERTY.

THE RAMIFICATIONS OF THIS ARE UNSETTLING AND POTENTIALLY FAR REACHING. NOT ONLY COULD THIS ADVERSELY AFFECT THE AVAILABILITY OF CREDIT TO BORROWERS DEEMED TO BE HIGH-RISK BUT IT COULD ALSO EXPOSE THE REGULATORY AGENCIES CHARGED BY LAW TO TAKE OVER INSOLVENT INSTITUTIONS TO INESTIMABLE LIABILITIES, THE COST OF WHICH COULD RAPIDLY DIMINISH THE RESOURCES AVAILABLE FOR RESOLVING FAILED INSTITUTIONS. THE COURT DECISIONS ALSO MAKE

UNCERTAIN THE POTENTIAL LIABILITY OF A BANK ACTING AS A FIDUCIARY THROUGH ITS TRUST DEPARTMENT FOR ASSETS IT MAY ADMINISTER.

MR. CHAIRMAN, I AM EXTREMELY SENSITIVE TO THE NEED TO CLEAN UP AND PROTECT THE ENVIRONMENT. I UNDERSTAND THE INCLINATION OF ENVIRONMENTAL ADVOCATES TO WANT TO PRESERVE THE AMBIGUITY OF LENDER LIABILITY; BANKS REPRESENT DEEP POCKETS TO THE PUBLIC AND LIKE MOST CRISES, THE ENVIRONMENTAL CLEAN UP EFFORT IS IN NEED OF DEEP POCKETS. YET I BELIEVE THAT COURT DECISIONS EXTENDING LIABILITY TO LENDERS, BY DETERMINING THAT A BANK ACTING TO PROTECT ITS SECURITY IS AN "OWNER" AS DEFINED BY CERCLA, HAVE GONE TOO FAR. THE POTENTIAL REPERCUSSIONS FOR SMALL BUSINESSES, FOR INSURED FINANCIAL INSTITUTIONS, AND FOR THE DEPOSIT INSURANCE FUNDS ARE TOO GREAT AND I BELIEVE THAT CONGRESS MUST ACT TO CLARIFY THE ORIGINAL INTENT OF CERCLA.

ONCE AGAIN, I COMMEND MY COLLEAGUE FROM UTAH FOR IDENTIFYING A SERIOUS PROBLEM AND INTRODUCING RESPONSIBLE LEGISLATION. IT MAY BE THAT AFTER DISCUSSION, SOME CHANGES NEED TO BE MADE, BUT I BELIEVE THAT THIS BILL IS AN EXCELLENT STARTING POINT.

THANK YOU, MR. CHAIRMAN.

Senator GARN. Thank you.

John, I appreciate your making that last point because this is not new law we're trying to do. We're trying to get back to where we were. And that was very well thought out. As you know, I was here at that time as well.

It does make a great deal of sense. We'll have the opportunity to hear from the EPA and the Environmental Defense Fund today. But, I'm a little bit surprised at their testimony because I don't consider this an environmental issue. Nobody's talking about watering down Superfund. Nobody wants those sites to stay there. We all want them cleaned up. Every one of us have sites of this type in our States, and we're doing the best we can to get them cleaned up.

But, to stretch this to whomever has the money, regardless of whether it's fair or not or whether they had any involvement—again, I want to emphasize both you and I have no desire to even attempt to exempt anyone who is at fault.

Representative LAFALCE. Absolutely.

Senator GARN. If they are at fault, they ought to be held responsible prior to the taxpayers for what they did.

Representative LAFALCE. And if that's going to be the effect of your bill and my bill, we'll amend your bill and my bill if it's a reasonable concern.

But you know, if the judicial interpretation of Superfund had been known to the Congress in December 1980, Superfund never would have been enacted into law. Never.

We never intended to make lenders fully liable for the cost of clean-up. We never intended to make lenders responsible for environmental clean-up of properties either. This simply was not envisioned whatsoever.

Senator GARN. I thank you very much. I have no further questions.

Senator SHELBY [presiding]. Senator Graham.

Senator GRAHAM. Mr. Chairman, I have no opening statement, or no questions. I appreciate Congressman LaFalce sharing with us his legislation.

Senator SHELBY. Thank you for coming over. Before we start, I have a statement for the record from Senator Dixon.

## STATEMENT OF SENATOR ALAN J. DIXON

Senator DIXON. Mr. Chairman, I am pleased to be here this afternoon as the Senate Banking Committee explores the subject of environmental lender liability.

I voted for the Superfund reauthorization in 1986. I believe that the cleanup of toxic waste sites must be a priority.

Legal developments in the area of environmental lender liability do raise some concerns in my mind. I look forward to the witnesses' testimony in order to be better able to evaluate what to do.

On the one side, frightening banks into curtailing their loan activity will not help clean up hazardous wastes. Denying access to credit to legitimate businesses does not promote a cleaner environment.

However, we also do not want to allow foreclosure or workout situations to become a means of avoiding Superfund liability. Inad-

vertently, I do not want to be party to creating any loopholes in the Superfund law.

I pledge to work with my colleagues, with lenders, and with environmentalists to make sure that both our environmental and financial needs are met.

Senator GARN. We'll have our first panel come up now.

Gentlemen, we're happy to have you before us. Mr. Seelig, do you wish to begin?

## STATEMENT OF STEVEN A. SEELIG, DIRECTOR, DIVISION OF LIQUIDATION, FEDERAL DEPOSIT INSURANCE CORPORATION, WASHINGTON, DC, ACCOMPANIED BY ROBERT F. MIAILOVICH, ASSISTANT DIRECTOR, OFFICE OF POLICY, DIVISION OF SUPERVISION

Mr. SEELIG. Good afternoon, Mr. Chairman, members of the committee. We appreciate this opportunity to present the views of the Federal Deposit Insurance Corporation on lender liability for hazardous substance clean-up costs and damages.

The concerns and views raised in our testimony are also shared by the Resolution Trust Corporation. We understand the RTC will be submitting its own statement to the committee.

The FDIC is very concerned about lenders' potential liability under Federal and various State environmental laws. As the insurer of banks and thrifts as well as the receiver or liquidator of failed banks and thrifts, we believe that the Federal Deposit Insurance System should not be threatened as a result of the environmental liability assessments.

As the insurer of about 15,800 financial institutions, we are anxious to see the safety and soundness of the banking and thrift system are not threatened as a result of lender liability for such laws.

The FDIC and RTC support the Lender Liability Act of 1990. The legislation would limit the diversion of deposit insurance funds from their primary purpose, the protection of depositors, and limit the escalating costs of resolving failed and failing savings and loans.

The environmental laws as presently interpreted also pose significant risks to our goal of protecting depositors. We believe it is extremely important that we do not divert deposit insurance moneys from their primary purpose, no matter how laudable the other goal.

Our written testimony provides background on how the FDIC may become directly involved with property which poses problems under current environmental laws; the risks to the FDIC and FDIC-insured lenders from potential lender environmental liability claims; how lenders have responded to the risks arising under current environmental laws, and, finally, our comments on proposed legislation to provide relief from environmental lender liability.

At the time of the FDIC's appointment as receiver of a failed bank, all assets of the failed institution come to the FDIC for liquidation. If the resolution of the failed institution is a purchase and assumption transaction, the assuming financial institution may purchase some or all of the assets of the failed institution.

Assets that come into the FDIC's possession may include nonperforming loans as well as real estate foreclosed upon by failed institutions.

Whenever possible, we attempt to confine these assets, and any potential liabilities associated with them, to the failed institutions' receivership estate in order to protect access to, and protect, the deposit insurance fund.

However, this is not always possible and we may have to assume the risk of environmental liability in our corporate capacity.

With regard to these retained assets, the FDIC as receiver is generally regarded as "standing in the shoes" of the failed institution. Although no cases have yet been decided in this area, we are concerned that the FDIC, as to these assets, may be treated just like any lender under the environmental laws.

We are also concerned that a court may some day determine that the FDIC, in its corporate capacity, is responsible for a receivership's environmental liabilities.

Indeed, if the FDIC in its corporate capacity ever becomes directly liable for environmental claims, our resources, designed to protect depositors, could be drained.

Should the FDIC be held liable for the clean-up costs of particular hazardous substance sites; even though the FDIC did not originally create this problem, this liability would cause the insurance fund to decline and increase the cost of resolving failed and failing financial institutions.

This would be particularly the case if the FDIC and the RTC in their corporate capacities are found to be chargeable with the liabilities.

The extent to which we are placed at risk depends largely upon the assets we hold. The more banks and thrifts that fail, the greater the potential for the assertion of environmental liability claims against the FDIC and the RTC, due to the sheer numbers of assets that we end up holding, at this time. At this time the FDIC is responsible for liquidating assets from 904 failed banks and 99 failed thrifts. The FDIC presently holds in its various capacities a total of approximately $13.2 billion in real estate related assets.

The FDIC is also liable for approximately $5.5 billion in real estate-related assets, resulting from large assisted bank transactions, and, further, the FDIC has approximately $13.8 billion in real estate-related assets resulting from the FSLIC assistance agreements.

Of the total assets held by the FDIC for liquidation, approximately 270 assets, with a total book value of about $365 million, have been identified to date as potentially having hazardous substance problems.

We have obtained clean-up estimates for approximately 50 of these properties and have been told that these costs may be more than three times the market value of these properties.

Additionally, it appears the FDIC may have liability on 50 properties with a book value of $200 million from the large bank-assistance transactions.

As the FDIC seeks to resolve failed financial institutions, interested purchasers increasingly raise concerns about potential environmental liabilities.

At times, these buyers seek indemnification from the FDIC for potential environmental liability claims. At other times, they seek drastic reductions in price to accommodate their concerns for environmental risks.

Ultimately, some buyers just refuse to purchase certain assets which they identify as having potential liability.

Because of buyers' concerns, we may carve out assets in some cases, choosing not to even attempt to transfer them. Too often, it is the FDIC and, thus, the deposit insurance funds, or the taxpayer that are left holding the bag.

The FDIC has additional exposure to the environmental laws that arise from the risk to lenders.

Lenders are faced with the specter of enormous liability assessments under the current environmental laws which deal with hazardous substances.

This is particularly true today in light of the recent decision of the U.S. Court of Appeals for the 11th Circuit. In the *United States* v. *Fleet Factors Corporation*, the circuit court held that a lender can be held liable for Superfund clean-up costs solely on the basis of the lender's participation in the financial management of a facility.

A lender may become liable under the Superfund as a result of being a present or past owner of a property, or if it's found to be an operator of a facility, where substances have been improperly released, stored or deposited.

Once a lender forecloses on collateral or otherwise obtains title to a borrower's property, the lender may become liable immediately for any costs incurred to mediate that property simply by the virtue of its being the current owner of the property.

The duration of the ownership, however brief, does not matter.

The *Fleet Factors* decision may have an enormous impact on lenders, particularly if the decision is adopted by other circuit courts. Lenders may have to change their loan underwriting practices and how they deal with defaulted borrowers.

Further, just as the Federal banking agencies are encouraging banks and thrifts to manage their loan portfolios more carefully, the decision in Fleet Factors may signal to lenders that they should be less involved in overseeing borrowers.

Should this occur, the FDIC's goals of promoting the safety and soundness of the banking and thrift system and the viability of deposit insurance may be frustrated.

Lenders clearly face significant potential risks under the current environmental laws and court rulings. Because the issues are still evolving, what is considered a prudent action by a lender today might become a cause for action tomorrow. Irrespective of the size of the loan, a Superfund lawsuit could result in a claim that is in excess of a lender's net worth.

While an individual charge-off is a normal occurrence in banking and can be managed, a Superfund lawsuit could cause the insolvency of an insured institution.

Most lenders have attempted to control their environmental risks. Almost all large institutions address hazardous waste and other environmental problems in their loan policies and their procedures manuals.

Smaller lenders usually deal with environmental issues on an ad hoc basis, seeking outside advice when necessary.

Before a credit decision is made, financial institutions often conduct environmental audits on potential loan customers that are involved in some way with hazardous wastes.

If the borrower is unable to repay the loan, many banks assess potential environmental risks before restructuring the loan or foreclosing on real estate held as collateral.

In addition to the cost and risk increases, the potential for environmental liability could have credit allocation consequences and could jeopardize the ability of certain segments of the economy to obtain financing and, therefore, to operate.

As stated previously, the FDIC on the whole supports S. 2827. However, we believe that the immunity afforded by S. 2827 should be strengthened.

And to the extent we can minimize judicial interpretation of the bill, once enacted, we will be able to save litigation-related expenses.

We would like to see the following three general changes.

No. 1, clarify and narrow FDIC, RTC potential liability.

No. 2, extend the exemptions to State and other Federal environmental laws.

And, No. 3, extend these immunities to those who purchase contaminated assets from us.

A detailed discussion of the individual provisions of S. 2827 as well as some recommended amendments are attached to our written statement.

In conclusion, we believe that it is altogether appropriate and necessary to exempt the FDIC and the RTC from liability under Federal and State environmental laws that deal with hazardous substances, except where we are the cause of the problem, and to clarify or limit the instances where a lender can be found liable.

The FDIC and RTC were created to safeguard the safety and soundness of the banking system, provide confidence to depositors and handle the savings and loan clean-up.

They were not created to solve the environmental problems confronting this country. Other agencies were created to deal with these problems and they can do so much more effectively and efficiently.

Particularly during these times, the energies and funds of the FDIC and the RTC should not be diverted from their primary mission, nor should the costs of cleaning up S&L's be confused with those of cleaning up the environment.

The FDIC and RTC thoroughly support the goals underlying current environmental laws. However, liability for remedying environmental problems should be borne by those who created them and not by banks and thrifts, or the FDIC and the RTC.

If those who are responsible for the problem are insolvent, then another insurance fund, if you will, exists to pay for them, the Response Trust Fund, created by Congress under Superfund.

That fund, not the FDIC's insurance funds, or the RTC's funds should bear the cost of environmental problems.

Thank you.

[The complete prepared statement of Steven A. Seelig follows:]

TESTIMONY OF

STEVEN A. SEELIG
DIRECTOR
DIVISION OF LIQUIDATION
FEDERAL DEPOSIT INSURANCE CORPORATION
WASHINGTON, DC

ON

ENVIRONMENTAL LENDER LIABILITY

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

2:00 PM
JULY 19, 1990
Room 538, Dirksen Senate Office Building

Good afternoon, Mr. Chairman and members of the Committee. We appreciate this opportunity to present the views of the Federal Deposit Insurance Corporation on lender liability for hazardous substance clean up costs and damages. The concerns and views raised in our testimony are also shared by the Resolution Trust Corporation. We understand the RTC will be submitting its own statement to the Committee.

The primary federal laws which impose liability on the basis of hazardous substances are the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) or, as it is commonly called, "Superfund," and the Resource Conservation and Recovery Act (RCRA). The FDIC is very concerned about lenders' potential liability under federal and various state environmental laws. As the insurer of banks and thrifts, as well as the receiver or liquidator of failed banks and thrifts, we believe the federal deposit insurance system should not be threatened as a result of environmental liability assessments. As the primary federal supervisor for almost 8,000 state-chartered nonmember commercial and savings banks with over one trillion dollars in assets, we are anxious to see that the safety and soundness of the banking and thrift system are not threatened as a result of lender liability under such laws.

On the whole, the FDIC and RTC support the "Lender Liability Act of 1990" (Subtitle B of S. 2827). The legislation would limit the diversion of deposit insurance funds from their primary purpose -- the protection of depositors -- and limit the escalating costs of

resolving failed and failing savings and loans. The FDIC is concerned about the protection of our environment. But, the environmental laws, as presently interpreted, also pose significant risks to our goal of protecting depositors. We believe it is extremely important that we not divert deposit insurance monies from their primary purpose, no matter how laudable the other goal.

Our testimony will provide background on how the FDIC may become directly involved with property which poses problems under current environmental laws. We then will address the risk to the FDIC and FDIC-insured lenders from potential environmental liability claims. We will discuss generally how lenders have responded to the risks arising under current environmental law. In addition, we will address the risk of loss to other agencies or instrumentalities of the Federal government. Finally, we will comment on proposed legislation to provide relief from environmental lender liability.

BACKGROUND

At the time of the FDIC's appointment as receiver of a failed bank, all assets of the failed institution come to the FDIC for liquidation. If the resolution of the failed institution is a purchase and assumption transaction, the assuming financial institution may purchase some or all of the assets of the failed institution. Even as to those assets assumed, the assuming institution may later put some assets back to the FDIC.

Unsold assets, or those "putback" to the FDIC, may include non-performing loans, as well as real estate owned by the institution as a result of foreclosure on collateral (generally termed, "owned real estate"). Thus, even under a purchase and assumption transaction, some assets -- such as secured notes and owned real estate -- may remain with, or be put back to, the FDIC. We attempt to confine these assets, and any potential liabilities associated with them, to the failed institution's receivership estate. This is done in order to prevent access to, and protect, the deposit insurance fund.

With regard to these retained assets, the FDIC as receiver is generally regarded as "standing in the shoes" of the failed institution. Although no cases have yet been decided in this area, we are concerned that the FDIC, as to these assets, may be treated just like any lender under the environmental laws. We are also concerned that a court may someday determine that the FDIC, in its corporate capacity as well, is responsible for a receivership's environmental liabilities. Indeed, if the FDIC in its corporate capacity ever becomes directly liable for environmental claims, our resources -- designed to protect depositors -- could be imperiled.

In summary, whether or not a purchase and assumption transaction is effected, the FDIC may find that it holds assets plagued by environmental problems. Furthermore, we may even find that some of these assets have outstanding Superfund liens against them. Clearly, current environmental laws may directly affect the soundness of the

federal deposit insurance funds and the stability of the deposit insurance system generally.

RISKS TO THE DEPOSIT INSURANCE FUNDS

The Environmental Protection Agency (EPA) has identified more than 30,000 Superfund sites in this country. As the EPA cleans up these sites, it is expected that litigation will escalate as the EPA seeks to shift clean-up costs, as it is statutorily required to do, to those originally responsible for the improper disposal.

At some point it will be argued that the FDIC is liable for the clean-up costs of a particular hazardous substance site, even though the FDIC did not originally create the problem. If a court upheld that argument, this liability would directly affect the insurance funds or increase the cost of resolving failed and failing savings and loans. This would be true particularly if the FDIC and the RTC in their corporate capacities are found to be chargeable with the liability.

The stability of the deposit insurance funds also may be adversely affected indirectly. The number of failures of insured financial institutions may increase due to lender liability for hazardous substance clean-ups. In turn, the financial condition of the deposit insurance funds would be weakened. Further, because environmental contamination problems, or the threat thereof, may lower the sale price of properties, the FDIC's recoveries from receivership

liquidations will decrease. Finally, to the extent that receivership estates are diminished by liabilities for clean-up costs, these receivership estates may not be able to repay the monies originally lent to them by the deposit insurance funds.

The FDIC does not face environmental liability risks because we created hazardous wastes or improperly disposed of these materials.[/] Instead, we face these potential liabilities as a result of our being an involuntary "owner or operator" of properties -- for however short a period of time these properties may be in our control -- and because wastes were released or deposited on those properties by others in the past.

The extent to which we are placed at risk depends largely upon the assets we hold. The more banks and thrifts that fail, the greater the potential for the assertion of environmental liability claims against the FDIC and the RTC, due to the sheer numbers of assets held. As this Committee knows, the number of banks and thrifts that have failed since 1983 has risen steadily. At this time, the FDIC is responsible for liquidating assets from 994 failed banks and 99 failed thrifts. The FDIC presently holds in its various capacities a total of approximately $13.2 billion in real estate related assets. The FDIC is also liable for approximately $5.5 billion in real estate related assets resulting from large assisted bank transactions. Further, the FDIC has approximately $13.8 billion in real estate related assets resulting from the FSLIC assistance agreements. The RTC also has a vast number of institutions and assets under its

jurisdiction. They can provide the Committee with their numbers.

As the FDIC seeks to resolve failed financial institutions, interested purchasers increasingly raise concerns about potential environmental liability. At times, these buyers seek indemnifications from the FDIC for potential environmental liability claims. At other times, they seek drastic reductions in price to accommodate their concerns for environmental risks. Ultimately, some buyers just refuse to purchase certain assets which they identify as having potential environmental liability claims. Because of buyers' concerns, we may carve out assets in some cases, choosing not to even attempt to transfer them. Too often it is the FDIC -- and, thus, the deposit insurance funds or the taxpayer -- that are left "holding the bag."

To date, the FDIC has been fortunate. Relatively few of our assets, to our knowledge, contain hazardous substance problems. Of the total assets held by the FDIC for liquidation, approximately 270 assets -- with a total book value of about $365 million -- have been identified at this time as potentially having hazardous substance problems. We have obtained clean-up estimates for approximately 50 of these properties and have been told that these costs may be more than three times the market value of these properties.

The FDIC holds other assets which may pose problems under other environmental laws. For example, the FDIC has an interest in more than 200 assets -- with a total book value of about $300 million --

which may have asbestos problems. We are not addressing these types of problems today because they are not generally affected by Senator Garn's bill. Yet, in considering this legislative initiative further, we urge you to consider expansion of S. 2827 so that it addresses these problems as well.

Inability to collect the principal of an asset is one thing. But, findings of Superfund liability on top of that could jeopardize the financial soundness of a financial institution and the deposit insurance system. Superfund liability assessments and the expenses incurred in litigating Superfund cases can be enormous. Given the large numbers of properties for which the FDIC is responsible, it can be anticipated that the FDIC may be compelled to incur these high Superfund clean-up costs, attorney fees, engineering fees and the like -- absent legislative change.

Further, the FDIC may be held liable for these costs -- even if the banks or thrifts involved failed years ago. As a case in point, we will describe briefly a lawsuit filed last year under CERCLA and RCRA.

Plaintiffs in the pending case seek damages of approximately $6 million based on allegations that hazardous substances were released beginning in the early 1950's on property they now own. The hazardous substances allegedly were found on the property in the late 1980's, and the current owners sued numerous prior owners and operators of the property.

In 1957 and 1959, legal title to portions of this property was transferred to a bank for the benefit of an employee's profit sharing retirement plan. The bank held legal title to the property as trustee of the plan but was not involved in the operation of the property. The property was leased back to the company that established the plan, pursuant to various leases.

Plaintiffs do not contend that the bank contributed to the alleged contamination. Rather, plaintiffs allege only that the property was contaminated during the time that the bank held record title. In 1973, the bank failed, the FDIC was appointed receiver, and the bank was sold under a purchase and assumption transaction. The FDIC became party to the lawsuit due solely to its brief role, in 1973, as receiver of the failed bank.

In this case, it appears that the FDIC may be able to avoid ongoing legal fees, engineering fees and payment of cleanup costs due to a fortuitous indemnification clause in the various leases. While this particular case should conclude with relatively moderate expense to the FDIC, we most certainly shall not always be so fortunate. In many cases, the FDIC will succeed to property interests without the benefit of such an indemnity.

<u>RISKS TO LENDERS</u>

The FDIC has additional exposure to the environmental laws that arise from the risk to lenders. Lenders are faced with the specter of enormous liability assessments under current environmental laws which

deal with hazardous substances. This is particularly true today, in light of a recent decision of the United States Court of Appeals for the Eleventh Circuit. In United States v. Fleet Factors Corporation ("Fleet Factors"), the Circuit Court held that a lender can be held liable for Superfund clean up costs solely on the basis of the lender's participation in the financial management of a facility. In reaching its decision, the Court made what has been described as an "extraordinary interpretation" of various sections of CERCLA. Even without the Fleet Factors decision, lenders face significant risks under the various federal environmental laws which deal with hazardous substances.

In addition, most states now have laws that parallel CERCLA and RCRA. Some of these state laws are even more onerous than the federal laws because they impose "Superliens" on properties subject to clean-up.

A lender may become liable under Superfund as a result of being a present or past owner of property, or if it is found to be an "operator" of a facility, where hazardous substances have been improperly released, stored or deposited. Once a lender forecloses on collateral, or otherwise obtains title to a borrower's property, the lender may become liable immediately for any costs incurred to remediate that property -- simply by virtue of its being the "current owner" of the property. The duration of the ownership -- however brief -- does not matter.

Moreover, Superfund does not specify the standard of liability that will be used to determine who is liable for clean up costs. It also does not describe or require a causal link for liability to attach. Nevertheless, the courts have determined that the standard of liability under Superfund is that of strict liability. Thus, subject only to certain very narrow defenses, a lender will be liable for Superfund clean up costs and damages the moment it becomes the owner of contaminated property.

A lender also may be held liable for Superfund costs and damages if it was a past owner of contaminated property. In fact, as the statute is interpreted, virtually any person in the property's chain of title following contamination may potentially be held liable. Thus, if a lender was a past owner of a property at any point after it became contaminated <u>and if</u> it can be asserted that berrels on the property containing toxic wastes, for example, continued to leak while the lender was the owner of the property, then the lender may be liable under Superfund.

A lender can attempt to take advantage of the limited number of statutory defenses available under Superfund. However, the lender's burden of proof is very high, since the courts have consistently construed these defenses very narrowly. The primary defense that lenders, as well as others, may raise is commonly called the "innocent purchaser" defanse. This defense excludes lenders from Superfund liability if they can establish that: (1) they acquired the

property after the hazardous substance disposal had occurred; and, (2) they did not know, and had no reason to know, that hazardous substances had been disposed on the property.

This latter requirement has been the subject of much judicial interpretation and has led to the development of a whole new industry. Lenders now must regularly undertake expensive environmental audits of properties before foreclosure, if they hope to later successfully raise the innocent purchaser defense. Even if an environmental due diligence audit is undertaken, uncertainty remains. No guidance is provided under the law or regulation as to what constitutes the "all appropriate inquiry" required to be protected from environmental liability. Finally, because of the expenses involved in attempting to establish the "innocent purchaser" defense, it is, ironically, somewhat punitive itself.

The situation is exacerbated by the recent Fleet Factors decision. The Court in this case interpreted a section of Superfund, which expressly excludes from the definition of "owner or operator" a person "who, without participating in the management of a... facility, holds indicia of ownership primarily to protect his security interest in the...facility." [42 U.S.C. Section 9601(20)(A)]. In the past, lenders believed this section provided protection from Superfund liability, so long as they did not participate in the operation of a facility. Lenders also generally understood that their risk of being held liable as an "operator" was a function of the nature and degree of their control over the

operations of a borrower's facility. More specifically, lenders generally thought that lender liability would not attach under Superfund unless they were involved in the day-to-day operations of a facility. In short, liability rested with the responsible, controlling party -- the owner/operator -- and lenders would be held liable only if evidence could be advanced similar to that presented in other, traditional lender liability suits.

However, the Court in Fleet Factors held that a secured creditor need not be involved in the day-to-day operations of a facility or actually participate in the borrower's decisions relating to hazardous waste management. Instead, a lender will be liable if the lender is participating in the financial management of a facility to such a degree as to permit the inference that the lender could influence the borrower's waste management decisions.

The Fleet Factors decision may have an enormous impact on lenders, particularly if the decision is adopted by other circuits. Lenders may have to change their loan underwriting practices and how they deal with defaulted borrowers. Further, just as federal banking agencies are encouraging banks and thrifts to manage their loan portfolios more carefully, the decision in Fleet Factors may signal to lenders that they should be less involved in overseeing borrowers. Should this occur, the FDIC's goals of promoting the safety and soundness of the banking and thrift system, and the viability of the deposit insurance system, may be frustrated.

LENDERS RESPONSE TO THE RISKS

Lenders clearly face significant potential risks under current environmental laws and court rulings. Irrespective of the size of a loan, a Superfund lawsuit could result in a claim that is in excess of a lender's net worth. While an individual charge-off is a normal occurrence and can be managed, a Superfund lawsuit could cause the insolvency of an insured institution.

Lenders have attempted to control their environmental risks in a number of ways. Almost all large institutions address hazardous wastes and other environmental problems in their loan policies and/or procedures manuals. Smaller lenders usually deal with the environmental issues on an ad hoc basis, seeking outside advice when necessary. Before a credit decision is made, financial institutions often conduct environmental audits on potential loan customers that are involved in some way with hazardous wastes. If the borrower is unable to repay the loan, many banks assess potential environmental risk before restructuring the loan or foreclosing on real estate held as collateral.

While lenders are aware of environmental risk and have taken action to limit their liability, the adequacy of the preventive measures cannot be evaluated because lender responsibility under Superfund legislation remains undefined. Various court interpretations indicate that almost any current or past owner could be held liable

for the cost of the cleanup, whether or not that owner was in any way responsible for the problem. It also is possible that a lender might incur liability even if it does not take possession of real property. Because the issues are still evolving, what is considered a prudent action by the lender today might become a cause of action tomorrow.

Unless the law is changed to exempt insured depository institutions and the FDIC and RTC from this potential but unrealized liability, it is possible that the next court ruling or regulation may have an unfavorable systemic impact on banks, savings and loans, and the deposit insurance funds.

RISKS OF LOSS TO AGENCIES OR INSTRUMENTALITIES OF THE FEDERAL GOVERNMENT

As discussed previously, there are several risks of loss to the FDIC and RTC that arise by reason of lenders' risks. The environmental liability that lenders face will place an increasing burden on the deposit insurance funds by accelerating, if not being solely responsible for, the capital depletion and insolvency of some insured depository institutions. Because lenders may understandably be unwilling to foreclose on collateral known to be contaminated, such loans effectively become unsecured. All of these factors may contribute to increased insolvencies.

In addition, the transactional costs associated with making loans are increased by the need to conduct environmental due diligence audits. Under the current state of the environmental laws, such audits must be conducted repeatedly -- before making a loan, renewing a loan, engaging in a workout with a borrower in default, and foreclosing on collateral. The simplest due diligence investigation can cost between $3,000 and $10,000 each and a lender may be required to perform hundreds of these due diligence investigations every year. This transactional cost may strain a financial institution's financial condition and most certainly lenders will attempt to pass the cost on to the customers.

In addition to the cost and risk increases, the potential for environmental liability could have credit allocation consequences that could jeopardize the ability of certain segments of the economy to obtain financing and, therefore, to operate.

We are unable to comment extensively about the risks of loss that agencies or instrumentalities of the Federal Government, like the Small Business Administration, for example, may face as a result of the risks to lenders. We imagine that the Small Business Administration may find that more small businesses, such as dry cleaners, are defaulting on their loans due to increased operating costs arising from environmental laws. Also, if lenders refuse to foreclose on collateral because of contamination, this may have some impact on agencies such as the Farmers Home Administration, the Federal Housing Administration, and the Small Business Administration that insure or guarantee these loans.

LEGISLATIVE PROPOSALS

S. 2827 (Subtitle B). "Lender Liability Act of 1990"

As stated previously, the FDIC on the whole supports S. 2827. It would limit diversion of deposit insurance funds from their primary purpose and limit escalation of the cost of resolving failed and failing savings and loans to the American taxpayer. However, we believe that the immunity afforded by S. 2827 should be strengthened. A detailed discussion of the individual provisions of S. 2827, as well as recommended amendments, are contained in an attachment to this statement. At this time, however, we would like to highlight three of our greatest concerns.

First, we have concerns about the provisions that deprive the FDIC and the RTC of immunity from environmental laws if they have either: "caused the release, or threatened release of a hazardous or potentially dangerous substance" or had "actual knowledge that a hazardous or potentially dangerous substance was located on [a] property but failed to take all reasonable actions necessary to prevent the release of such substances."

We believe these provisions are overly broad and ambiguous. They could open the FDIC and RTC to expensive and unnecessary litigation on their intended scope, as well as to liability for environmental clean-up costs in circumstances not intended by Congress. For example, the requirement that the FDIC and the RTC take "all reasonable actions necessary" to prevent the release of a substance,

if interpreted broadly by the courts, could entirely eviscerate the purpose of S. 2827 to grant a Superfund exception for the FDIC and the RTC. We suggest that these provisions be more clearly defined or narrowed to ensure that they do not undo the basic thrust of S. 2827. We have some suggestions in the attachment to this testimony, and we would be happy to work further with the members of this Committee to draft appropriate language.

Second, we suggest inclusion of language to clarify that the immunity granted the FDIC and the RTC extends to those who purchase contaminated property from the FDIC or the RTC. The bill is ambiguous on this point. As previously discussed, the deposit insurance funds and the cost of the savings and loan bailout may be adversely affected to the extent that we cannot sell properties. So that we are not left "holding the bag" and to ensure that properties in our hands are indeed marketable, the immunity afforded the FDIC and the RTC must be transferable to those who buy contaminated properties from us.

Finally, it is unclear exactly what laws will be affected by the immunity granted the FDIC and the RTC under S. 2827. As drafted, the bill provides the FDIC and the RTC with immunity from "any law imposing strict liability for the release... of hazardous substances...." The language, "any law," may invite disputes regarding the scope of the immunity. We suggest that either the law or the legislative history reflect clearly that "any law" encompasses "any federal, state or local statute, regulation, rule, ordinance or

common law." This will clarify that the FDIC and RTC are immune not only from federal laws dealing with hazardous substances but also similar laws and regulations of other governmental units.

The foregoing amendments, as well as those contained in the attachment to this statement, are suggested to strengthen the immunity afforded the FDIC and the RTC under S. 2827. To the extent that we can minimize judicial interpretation of the bill once enacted, we will be able to save litigation-related expenditures.

H.R. 4494

While we support the bill introduced by Congressman LaFalce, H.R. 4494, it is not clear that the protection afforded to lending institutions by that bill would extend to the FDIC and the RTC.

H.R. 4494 protects those who make loans secured by properties affected by Superfund. However, neither the FDIC nor the RTC typically make secured loans. As a result, H.R. 4494 is not adequate to protect those agencies. In addition, H.R. 4494 does not provide any exemption from liability under other federal environmental laws, such as the Resource, Conservation and Recovery Act -- nor dces it limit lenders' potential liability under state environmental laws. For any hazardous substance exemption to be fully effective, we believe it must cover not only Superfund but also other related federal environmental laws, state laws, local initiatives and common law.

H.R. 4076, the "Federal Custodial Responsibility Protection Act of 1990

The FDIC generally favors the legislative initiative set forth in H.R. 4076, which was introduced by Congressman Conte. This bill would exempt federal agencies from Superfund liability when they acquire properties through foreclosure and similar means. While H.R. 4076 may provide some measure of relief to the FDIC and RTC, it would not fully protect the deposit insurance funds or limit the costs of the savings and loan bailout. Like the bill introduced by Congressman LaFalce, its exemption is limited to Superfund. As a result, it may not provide protection from suits filed under other federal environmental laws, state laws or common law. In addition, it is not clear that H.R. 4076 would provide the FDIC with protection from Superfund liability when we are acting in our receivership or conservatorship capacity.

CONCLUSION

In conclusion, the FDIC is vitally concerned with the risks posed by hazardous substance claims. The greatest risk of such claims is that they may divert deposit insurance funds, and taxpayers' money allocated to resolve the savings and loan crisis, from their intended purposes. The legislative initiatives now being considered will help ensure that these funds and monies are spent properly. They also will promote the safety and soundness of the banking and thrift system.

We believe that it is altogether appropriate and necessary to exempt the FDIC and the RTC from liability under federal and state environmental laws that deal with hazardous substances and to clarify or limit the instances when a lender can be found liable. The FDIC and RTC were created to safeguard the safety and soundness of the banking system, provide confidence to depositors and handle the savings and loan bailout. They were not created to solve the environmental problems confronting this country. Other agencies were created to deal with these problems and they can do so much more effectively and efficiently. Particularly during these times, the energies and funds of the FDIC and the RTC should not be diverted from their primary missions.

The FDIC and RTC thoroughly support the goals underlying current environmental laws. However, liability for remedying environmental problems certainly should be borne by those who created them and not by banks and thrifts or the FDIC and the RTC. If those who are responsible for the problem are insolvent, then another "insurance fund," if you will, exists to pay for them -- the "Response Trust Fund" created by Congress under Superfund. That Fund, and not the FDIC's insurance funds or the RTC's funds, should bear the cost of environmental problems.

July 19, 1990

**FDIC & RTC LEGAL STAFF COMMENTS ON SUBTITLE B OF S. 2827, THE LENDER LIABILITY ACT OF 1990**

The following are substantive and technical comments on Subtitle B of S. 2827. Where appropriate, we have included revised statutory language.

AGENCY IMMUNITY - Subsection (d)

1. As presently drafted, subsection (d) exempts the FDIC, RTC, and the other listed entities from liability "...under any law imposing strict liability for the release ... of hazardous substances...". To ensure that the term "any law" exempts the listed entities from liability not only under Federal law, but under state and local statutes, as well as common law, we suggest that the term "any law" in subsection (d) be replaced with the following language: "any federal, state or local statute, regulation, rule, ordinance or common law".

2. Subsection (d) provides an exemption from "any law imposing strict liability...". The term "strict" liability is not defined in Subtitle B nor is it defined or used in the various environmental statutes, including the Comprehensive, Environmental Response, Compensation and Liability Act (CERCLA). Accordingly, it could be interpreted to narrow inappropriately the exemption granted under subsection (d). We strongly recommend that the term "strict liability" be replaced with "liability".

3. We suggest that subsection (d) ba amended to clarify that the exemption from liability granted to the FDIC, the RTC, and the other listed entities extends to the employees and agents of these entities, as well as to the entities themselves. Inclusion of this clarifying language will resolve questions that may arise as to the scope of the exemption and avoid needless litigation.

4. Subsection (d) as presently drafted contains the phrase, "hazardous substances or similar material". The phrase, "similar material," is ambiguous. It is not defined in Subtitle B or in any federal environmental statute. This phrase also is not a term of art used in the area of hazardous substance liability litigation. As a result, we recommend that it either be defined or deleted.

5. Subsection (d) provides that the listed entities shall not be liable "under any law imposing strict liability for the release, threatened release, use, storage, or disposal of hazardous substances...". While the language used in the foregoing phrase covers most of the bases for liability under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), it does not precisely refer to all CERCLA bases of liability. As a result, we suggest that the phrase be modified to read:

   "...under any law imposing liability for the release, threatened release, use, storage, disposal, treatment, generation or transportation of hazardous substances...".

6. To be consistent with terminology used elsewhere in Subtitle B, we suggest that the term, "Agency Immunity" used in the title of this subsection be replaced by the term, "Agency Exemption". Use of the term, "Agency Exemption" also will avoid potential confusion with statutes and case law dealing with sovereign immunity.

● In summary, we recommend that the beginning of subsection (d) be modified as follows:

(d) Agency Exemption.

"Neither the Corporation, the Resolution Trust Corporation...nor the Farm Credit Administration in any of their capacities shall be liable, nor shall any of their employees and agents be liable, under any federal, state or local statute, regulation, rule, ordinance or common law imposing liability for the release, threatened release, use, storage, disposal, treatment, generation or transportation of hazardous substances from property acquired-- ...".

EXCEPTIONS TO AGENCY IMMUNITY - Subsection (d)

1. Two bases are contained in subsection (d) to deprive the FDIC, RTC, and other listed entities of superfund immunity:

   ● First, immunity is unavailable if the agency "has caused the release, or threatened release of a hazardous or potentially dangerous substance".

   ● Second, immunity is unavailable if the agency "had actual knowledge that a hazardous or potentially dangerous substance was located on such property but failed to take all reasonable actions necessary to prevent the release of such substances."

There are a number of problems with the language of these exclusions:

- The term "potentially dangerous substance" used in both exclusions is neither defined in Subtitle B nor in any federal environmental statute. In addition, the term is not used in the grant of immunity contained in subsection (d). As a result, it should either be deleted from this subsection or defined in the Subtitle.

- The use of the term "release" in conjunction with causation as the basis for removing agency immunity under the first exclusion is extremely problematic. The term "release" is defined in Superfund as "any spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping leaching, dumping or disposing into the environment...". 42 U.S.C. section 9601(22).

  Many of the actions listed in the definition of "release" such as "leaking" and "leaching" may purely be the result of prior owners actions and resultant chemical reactions Furthermore, some of the actions included in the definition of "release" may be extremely difficult to pinpoint as to the time of the "release" with any accuracy Should it be argued that a "release" occurred while the FDIC or RTC owned a property, it may be extremely difficult to produce evidence to prove that no "release" of hazardous substances occurred while the property was in the hands of the FDIC or RTC.

  In view of the foregoing, this exclusion from immunity should be clarified, narrowed or deleted. We suggest that the bill provide that the FDIC or RTC must be the "sole cause" of or the agent that initially caused, the release or threatened release of the hazardous substance. Absent such clarification, we believe that the goals of S. 2827 will be significantly frustrated and the deposit insurance funds and RTC may again be endangered.

- The phrases, "actual knowledge" and "all reasonable actions necessary" contained in the second exclusion are extremely broad and ambiguous. Consequently, they are likely to subject the FDIC and RTC to expensive and unnecessary litigation.

- Furthermore, the phrase "all reasonable actions necessary", if interpreted broadly by the courts, would eviscerate the basic purpose of this legislation, which is to grant an exception from Superfund liability for the FDIC, RTC, and the other listed entities. We suggest that the term be defined or narrowed.

The FDIC and RTC must act quickly to resolve failed financial institutions and, consequently, may not have "actual knowledge" of problems associated with properties at the time of their acquisition. Nonetheless, litigants will undoubtedly argue that we had "actual knowledge" of a problem when they seek to deprive the FDIC and RTC of immunity under subsection (d). Accordingly, the FDIC and RTC will be placed once again at risk of liability and forced to incur substantial attorneys fees. We suggest that this phrase be deleted.

2. As a technical drafting matter we suggest that the exceptions to agency immunity be moved to a separate subsection, rather than simply being a part of subsection (d).

MATTERS NOT ADDRESSED IN S. 2827

1. Transferal of immunity. Language should be included to clarify that the immunity granted the FDIC and RTC extends to those who purchase contaminated property from the FDIC and RTC The bill as presently drafted is ambiguous on this point. Absent such a provision, the ability of the FDIC and RTC to sell properties would be greatly impaired.

Such an amendment is consistent with the goal of requiring those who created the hazardous substance problem to pay for its clean up The cost of remediating environmental problems should lie with Superfund, not the deposit insurance funds or the RTC. By extending the immunity afforded by S. 2827 to the FDIC's and RTC s buyers the values of properties sold by the FDIC and RTC will be enhanced and, thus, the deposit insurance funds will be protected and the cost of the savings and loan bailout reduced.

2. Exemption from liability to purchasers under 42 U.S.C. 9620(h). S. 2827 does not address its relationship with 42 U.S.C. 9620(h), which requires federal agencies to provide certain covenants or warranties to buyers when they sell properties. Under 42 U.S.C. 9620(h), a federal agency must warrant (1) that it has cleaned up hazardous substances on the property transferred; and (2) that it will pay for any clean up costs which arise in the future While S 2827 would exempt the FDIC and RTC from hazardous substance liability *per se*, the risks associated with the warranties required by 42 U.S.C. 9620(h) remain.

To resolve this dilemma S. 2827 should be amended to provide that the entities covered by subsection (d) are exempt from providing the warranties identified in 42 U.S.C. section 9620(h). This recommended exemption is consistent with our prior suggestion that the immunity granted the FDIC and RTC under subsection (d) be extended to those who buy properties from us.

3. Impact of 42 U.S.C. 9607(1). The bill does not appear to contemplate the impact of 42 U.S.C. 9607(1) on the immunity provided the agencies under subsection (d) of Subtitle B. Section 9607)(1) of Title 42 imposes a federal lien on property that has benefited from a clean up funded by the federal government through Superfund. In the event a lien is imposed under Section 9607(1) or an analogous state statute on property acquired by the FDIC or RTC, the protection afforded the deposit insurance funds and the RTC may be greatly diminished and the value of that property to the FDIC or RTC would be greatly reduced. We suggest that S. 2827 be amended to provide an exemption from 42 U.S.C. 9607(1) for the entities granted immunity under subsection (d) of Subtitle B.

Senator GARN. Thank you, Mr. Seelig. I would just note that S. 2827 does preempt State law.

Mr. Strock.

## STATEMENT OF JAMES M. STROCK, ASSISTANT ADMINISTRATOR, OFFICE OF ENFORCEMENT, ENVIRONMENTAL PROTECTION AGENCY, WASHINGTON, DC

Mr. STROCK. Thank you, Senator Garn and Senator Graham. I am James Strock, the Assistant Administrator in charge of Enforcement for the U.S. Environmental Protection Agency. I appreciate the opportunity to appear before you this afternoon and would like to introduce to you several people, also from EPA, who are here.

Mr. Bruce Diamond, Director of our Office of Waste Programs Enforcement, is with me at the table. Also accompanying us are Raymond Ludwlszewshi, EPA's deputy general counsel, and David Van Slyke, our lead enforcement counsel for Superfund.

Senator Garn, with your leave, I would like to submit my written statement for the record and, at this point, provide a summary oral statement.

Senator GARN. Your statement will be included in full in the record.

Mr. STROCK. I would like to begin by thanking you and the other members of this committee for your leadership in holding this hearing today. You have brought together representatives in our Nation's efforts at continued environmental improvement as well as those concerned with the maintenance of a strong public and private financial system.

There is no question but that there is a need for greater dialog and learning between those concerned with both of those issues. I can assure you that the EPA will enter this dialog earnestly.

I would also add that Mr. Seelig and I, for example, have not met before today and it's very plain from hearing his testimony and by the questions you've already raised that we need to get together very soon.

Questions of lender liability under environmental statutes have largely arisen under a single law, the Superfund law, already noted.

EPA is keenly aware that some people feel a sense of uncertainty about liability rules in this area as they affect financial transactions.

Part of our job at this time must be to make these rules as clear as possible within both the spirit and letter of the existing statute itself.

Your bill, Senator Garn, S. 2827, clearly represents a thoughtful effort to provide such clarity. However, given the many questions it raises with implications across the Government and the private sector, the administration has decided not to take a position on your proposal at this time.

Instead, we would intend to use the proposal as well as the issues raised at this hearing to inform us in a full interagency analysis of these questions.

Following that analysis, we would provide additional comments for the consideration of the committee.

There are several key matters I would like to bring to your attention at this time.

First, the Superfund statute by its nature brings within its liability ambit a wide range of parties who feel aggrieved.

As you know, Superfund's liability provisions are unique in American law. Liability is, to use lawyers' words, strict, joint and several, and retroactive.

In plain English, this means that an individual who is not in violation of hazardous waste laws at the time of disposal may, nonetheless, be held liable later.

What is more, such an individual may be held liable to the Government for the entire clean-up, even though many others also contributed to the contamination.

The recourse left to such a party is to sue other parties for contribution. Realizing the uniqueness of the hazardous waste challenge and the unique powers in this statute, Congress made a very difficult judgment in adding this to the statute in 1980.

I would urge the committee to consider the context of this overall statutory scheme in evaluating the particular and unique questions posed by lending institutions.

Second, it is important to consider that the Superfund statute presently includes specific provisions which may give protection to lending institutions.

For example, there is a specific exclusion for, quote:

> A person who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interests in the vessel or facility.

End quote.

There is also an innocent landowner defense added by the Congress in 1986. This provision provides that a party acquiring contaminated property may not be liable when the party was unaware of the contamination, and had diligently inquired into the environmental quality of the property prior to acquisition.

Further, it is possible that an additional innocent landowner defense relating to the, quote:

> Involuntary transfer or acquisition of property may have specific application in transactions of the FDIC, RTC and other Federal lenders.

Third, I wish to stress that the Environmental Protection Agency stands prepared to work with you and others to provide clarity on lender liability.

One year ago, the agency published guidance on landowner liability, specifically including language concerning some lending transactions.

Further, at the present time, EPA is carefully monitoring the development of due diligence guidelines in various contexts by private and public entities.

At present, we are also working with the Department of Justice to assure that the Government's legal positions on lender liability are fully consistent.

Now, we intend to broaden that review through a dialog with FDIC, RTC and other relevant entities.

In closing, I wish to stress the wide area of shared interests among those from whom you will hear today. The lending community seeks certainty and predictability and seeks to protect collateral from environmental and other liabilities.

For its part, the Government also seeks certainty and predictability and also seeks to protect property from environmental damage.

Viewed from this vantage point and with your help, there is great potential for progress toward our shared goals.

[The complete prepared statement of James M. Strock follows:]

**STATEMENT OF**
**JAMES M. STROCK**
**ASSISTANT ADMINISTRATOR FOR ENFORCEMENT**
**UNITED STATES ENVIRONMENTAL PROTECTION AGENCY**
**BEFORE THE**
**COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS**
**UNITED STATES SENATE**

**July 19, 1990**

Good afternoon, Mr. Chairman and members of the Committee. I am James Strock, Assistant Administrator for Enforcement at the United States Environmental Protection Agency. Thank you for the opportunity to be here today to discuss the merits of the proposed legislation, S. 2827.

The concept of further defining the liability of lending institutions under this nation's hazardous waste laws is supportable. However, there are several complex issues and uncertainties associated with this recently introduced legislation that affect several federal government departments. The Administration has begun a full interagency analysis of these issues and therefore does not have a position on this legislation at this time. When this analysis is complete, the Administration will provide additional comments.

As you know, the issue of defining the liability of lending institutions surfaces primarily in the context of liability under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended (CERCLA or "Superfund"). EPA is well aware of the concerns expressed by the lending community and we do not want uncertainty about liability rules unnecessarily to inhibit financial transactions. We view an important part of our

mission to be to ensure that the law functions as intended and that the rules are as clear as possible. Accordingly, we are willing to discuss any legitimate concerns within the spirit and letter of the current Superfund statute and to provide guidance.

As the Administrator has stated, the mere act of lending money does not and should not trigger responsibility under Superfund. Rather, the potential liability of lenders arises only when more than lending is involved. The purpose of this testimony is to lay out when those circumstances occur and to identify the steps EPA's enforcement program has taken and is taking with others to ensure that responsibility is only imposed where appropriate.

The starting point for analyzing this issue is the statute, CERCLA, itself. The liability provisions of CERCLA, found in Section 107, generally provide that owners or operators, parties that were owners or operators at the time of disposal of the hazardous substances, generators of hazardous substances, and transporters of hazardous substances who select the disposal site are liable under CERCLA for remediating the site in question or reimbursing the Superfund trust fund in the event the United States undertakes the cleanup using Superfund monies. The liability provisions typically in question regarding lending institutions are Sections 107(a)(1) and (2), which state that "the owner or operator of a vessel or facility, [or] any person who at the time of disposal of any hazardous substance owned or operated any facility at which such hazardous substances were disposed of ... <u>shall be liable</u> for all costs of removal or remedial action incurred by the

United States ...." The liability of owners and operators is not contingent on proof that they caused the release or threatened release of hazardous substances.

Under Section 107 of CERCLA, lenders, like other entities involved with hazardous waste sites, may be potentially liable as either past or present site owners or operators. Congress, however, in defining "owner or operator" in Section 101(20)(A) provided a specific exclusion from the definition of owner or operator for "a person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility." This is known as the "secured creditor exemption" and has been in CERCLA since it was first passed in 1980. In addition, Section 107(l) of CERCLA, the lien provision, gives EPA authority to file liens on property where Fund money is spent, but does not create a "super lien" which would take precedence over liens already perfected, such as liens held by lenders.

The liability section of CERCLA, in Section 107(b)(3), also details the three available defenses to CERCLA liability: when the release or threatened release was caused by (1) an act of God; (2) an act of war; or (3) an act or omission of a third party other than an employee or agent of the defendant, or one whose act or omission occurs in connection with a contractual relationship, existing directly or indirectly, with the defendant. Section 101(35)(A) contains a definition of the term "contractual relationship," added when CERCLA was reauthorized by the Superfund

Amendments and Reauthorization Act of 1986 (SARA), which clarifies Congressional intent to afford owners a defense to liability, the so-called "innocent landowner defense," under certain specific circumstances. Under the facts of a particular case, this contractual relationship defense may be available to lenders. That is, a subsequent owner or operator does not incur liability under CERCLA for prior releases caused by acts of a third party if the subsequent owner or operator made: (1) all appropriate inquiry (e.g., a "due diligence" search) prior to acquiring regarding the property; (2) acquired the property with no reason to know that any hazardous substances that are the subject of a release were disposed of at the facility; and, (3) exercised due care in the event a release or threat of release of hazardous substances occurred.

The innocent landowner defense, under section 101(35)(A), is also available to a governmental entity, such as Federal Deposit Insurance Corporation (FDIC) and Resolution Trust Corporation (RTC). Section 101 (35)(A)(ii) specifically recognizes that there is a defense to liability if a governmental entity acquired the facility by escheat, or through any other involuntary acquisition, or through the exercise of eminent domain authority by purchase or condemnation. Since we are aware of no case law interpreting what constitutes "involuntary" acquisition, EPA is willing to discuss application of these provisions to FDIC, RTC and other similar

federal entities. We will commit to meet with the FDIC and other federal lenders in the very near future and report to the Committee with the results of those discussions.

In view of this, under the CERCLA liability scheme, lending institutions generally are not liable parties. Indeed, before they fall into the ambit of Superfund, banks must cross a line from their typical "creditor" status and become owners and/or operators of the Superfund facility. During the SARA reauthorization debates, Congress, while preserving the original secured creditor exemption, added the Superfund lien provision and the innocent landowner defense in a manner that was intended to address and resolve the tension between the interests of lenders and the need for EPA to obtain cost recovery.

This regime is intended to foster responsible behavior. In addition, it treats lenders, in situations where they have become owners or de facto operators, like any other similarly situated parties. Ownership and operational participation appropriately carry with them the obligation to comply with environmental laws.

In addition, it is important to recognize that the United States exercises its discretion in administering CERCLA's liability scheme. For example, each case involves first and foremost, a thorough analysis of a party's legal liability. Then we consider the party's ability to pay, and its responsibility for the condition of the site. With respect to private cost recovery actions, most are actions in contribution where one or more responsible parties seek their fair share from other parties. In

these cases, section 113 of CERCLA provides the courts with several equitable factors to apportion responsibility and, as a result, issues relating to liability, viability and culpability come into play. Thus, in these contribution cases, lenders who have become owners and operators will be equitably treated.

These statutory requirements have been applied by the courts in the few cases to date that address lender liability. Those cases include both cases brought by the United States and cases brought between private parties. It is worth noting that it may well be in the interest of private business to seek cost recovery against lenders. Each case thus far has had its own unique set of facts regarding, among other things, the lending agreement, the lender's role in facility management, and the nature and extent of the lender's role as an actual owner, for example, as a result of foreclosure by the lender.

In the case, <u>United States. v. Maryland Bank and Trust</u>, 632 F.Supp. 573 (D.Md 1986), the bank foreclosed on its mortgage, purchased the property itself at the foreclosure sale and <u>held the property in fee simple for approximately four years</u> before EPA sued the bank to recover the cost of the Superfund-funded cleanup. While the bank argued that the "security interest exemption" should apply, the court rejected that position, noting that the exemption applies only during the life of the mortgage and that once the bank purchased the property at the foreclosure sale it was an owner for purposes of CERCLA liability. The court also noted that if it applied the exemption to the bank, the bank would be unjustly

enriched since "the federal government alone would shoulder the cost of cleaning up the site, while the former mortgagee-turned-owner, would benefit from the clean-up by the increased value of the now unpolluted land. . . . In essence, the defendant's position would convert CERCLA into an insurance scheme for financial institutions, protecting them against possible losses due to the security of loans with polluted properties."

The Eleventh Circuit also recently addressed some of these issues in the case United States v. Fleet Factors, No. 89-8094 (11th Cir. May 23, 1990). Because this matter is still in litigation, it is not appropriate for me to comment on the facts that will be reviewed by the district court, or the Eleventh Circuit's holding. I can, however, say the following: In this case, the United States seeks recovery of over $400,000 in costs incurred by the Superfund to clean up a defunct cloth printing facility in Georgia. In Fleet Factors, the district court, among other things, denied Fleet Factor's motion for summary judgment because it concluded that Fleet's activities at the facility, if the government's allegations were proven at trial, might rise to the level of participation in management sufficient to impose liability under CERCLA, and take Fleet outside the protection of the statutory exemption from liability for holders of security interests. On appeal, the Eleventh Circuit agreed with the District Court that Fleet might be directly liable as an operator of the printworks, if the facts alleged by the United States were proved. Those facts include Fleet's handling of barrels of

hazardous waste and its removal of machinery, in the course of selling off equipment on which Fleet foreclosed, in a manner that released asbestos. Though the court found Fleet liable as an operator, the decision also discussed the meaning of the statutory phrase "participating in the management" of the facility. The court noted that secured creditors may be liable under Section 107(a)(2) without being an operator if they "participat[ed] in the financial management of a facility to a degree indicating a capacity to influence the corporation's treatment of hazardous wastes."

It is important to put the Eleventh Circuit's discussion in context. In the Fleet Factors case, the United States alleged that Fleet, in the course of winding down operations and selling off equipment on which it had foreclosed, had complete control of the property and handled barrels of hazardous waste and removed machinery in a manner that released asbestos. On the facts of the case the United States argued against a grant of summary judgment to Fleet Factors on the issue of Fleet's participation in the operational management of the facility. If Fleet's petition for rehearing en banc is denied, the matter will be remanded to the District Court for resolution of these alleged facts. It is important to note, however, that this case and others involving lender liability must be viewed in light of their facts.

We are aware of the concerns in the lending community raised by Fleet Factors. As a consequence, we intend to issue guidance on the definition of "participating in the management of a

facility" under the secured creditor exemption to the definition of "owner or operator." We believe that through administrative actions of this type EPA can continue to responsibly implement the CERCLA liability system in a manner that strikes an appropriate balance with respect to lender liability. In addition EPA and DOJ are reviewing the generic issues associated with secondary liability. We hope to have that legal review completed by October 15, 1990.

Moreover it is important for the Committee to recognize that EPA and other federal agencies have already provided guidance to lenders on how to direct their affairs in the meantime. A year ago, the Agency published a guidance document on landowner liability which, among other things, addresses lender liability in cases of foreclosure or acquisition through similar means. The document, entitled "Guidance on Landowner Liability under Section 107(a)(1) of CERCLA, De Minimis Settlements under Section 122(g)(1)(B) of CERCLA, and Settlements with Prospective Purchasers of Contaminated Property," was issued to Agency personnel on June 6, 1989 and published in the Federal Register on August 18, 1989, at 54 F.R. 34235. The guidance gives guidelines on when EPA views lenders as responsible parties under CERCLA, details EPA policy on settlements with prospective purchasers, and offers circumstances under which lenders may be eligible for settlement as a de minimis (i.e., non-major) party.

There are already several potentially relevant guidelines available regarding the kind of inquiry that generally may be

required to take advantage of the innocent landowner provision of Section 101(35). For example, there are Federal Home Loan Mortgage Corporation standards applicable to certain lenders governing the degree to which such lenders will be expected to investigate property conditions before entering into mortgage or other relationships with landowners. We understand that other industry guidelines are in place in this area and that the American Society of Testing and Materials (ASTM) and American Institute of Environmental Property Auditing (AIEPA) are currently developing due diligence guidelines. EPA is monitoring both of those efforts. The product of these efforts should be instructive with respect to the character of the inquiry lenders must undertake to avoid CERCLA liability.

All these activities will inevitably aid us in responsibly implementing the CERCLA liability system as provided for in the current law and in a manner that strikes an appropriate balance with respect to lender liability.

In this regard, we are not unmindful of the current Savings and Loan crisis and the concerns that the FDIC and RTC have regarding potential environmental liability claims on deposit insurance funds. As I noted above, we are committed to meet with these organizations in the near future.

We have also heard, through the media and in testimony by lenders and others before the House Committee on Small Business regarding a bill introduced by Congressman LaFalce (H.R. 4494), that environmental liabilities are causing a "credit crunch" and

that potential borrowers have gone wanting due to the unavailability of loans. We have not seen any data to support this general allegation, but would welcome any information available on this matter, particularly to the extent that it reflects that the environment suffers as a result of such a problem. We would of course take this information into account in our further examination of this issue.

We have briefly reviewed the legislation proposed here, S. 2827, and Representative LaFalce's bill now before the House of Representatives, H.R. 4494. Both bills would broadly exempt lending institutions and fiduciaries from liability under CERCLA; S. 2827 also exempts them from other environmental laws. The existing liability scheme under CERCLA has taken years to clarify. Legislative efforts to amend that scheme involve extremely complex economic and environmental issues, such as whether and in what situations the taxpayers should protect a lender's investment. If it is ultimately determined that legislation is needed, the objectives of any such legislation should be precisely identified, and the language should be drafted in accordance with those objectives, so that it does not impact unintended targets nor omit entities in the same situation as the intended beneficiaries.

In summary, as head of the Office of Enforcement at EPA, I am committed to vigorously enforcing the law and am well aware of the public demand for expeditious hazardous waste cleanup and payment

by the responsible parties. Many competing interests make Superfund enforcement one of the most complex program EPA has dealt with to date.

Review of our enforcement docket demonstrates that we have limited our focus, consistent with the statute, to lenders who actually assumed responsibility for the contaminated property and/or have engaged in operational management of facilities. Moreover, the innocent landowner defense, the de minimis landowner settlement provision, and the right to contribution in current law provide additional mechanisms for dealing with these issues.

This concludes my prepared remarks. I am happy to answer any questions you may have.

Senator GARN. Thank you, Mr. Strock. Maybe the most important thing I've heard here today is that you're going to talk to the FDIC.

Frankly, that disturbs me. It seems to me the head of the FDIC and the Administrator of EPA are both appointed by the President of the United States. And I'm a little bit puzzled by the disparity in viewpoints.

And so I would suggest that you do talk. I'm disappointed that that talk has not gone on a long time before now.

May I encourage you to do that because our problem on this committee is not an environmental problem, it is the greatest financial catastrophe that has ever occurred in this country with our financial institutions.

I can't sit here and listen to all this legal talk when we're not talking, not one of us is talking, about problems of the environment, or not wanting to clean up.

I don't disagree with the words you've said, but there's got to be some sanity here of not adding to the problem of the FDIC and the depositors out there and this incredible cost that we've got to bear.

If there's more money needed in Superfund there's a proper way to do this. You come back to the Congress and ask us to appropriate money but not exacerbate this catastrophe that's going on, that some estimate now is as much as a trillion dollars.

Let's have some common sense and let's have two agencies whose appointed officials are appointed by the same President start talking, or I'll call the President and say:

"Mr. President, can you get your administration talking with each other? We've got a problem here."

He's certainly aware of the problem of the thrift institutions. His first bill that he sent up when he became President was to try and minimize this crisis.

So, get together.

Mr. STROCK. Sir, thank you. I assure you that we will make a redoubled effort to do so very soon.

Senator GARN. Mr. Strock, in the *Fleet Factors* case, the Government argued that a secured creditor that participates in any manner in the operation of the company should be liable as an owner or operator of the property.

The court of appeals rejected this position as too Draconian. In fact, the court stated:

> We decline the Government's suggestion because it would largely eviscerate the exemption Congress intended to afford secured creditors. Secured creditors frequently have some involvement in the financial affairs of their debtors in order to insure that their interests are being adequately protected. To adopt the Government's interpretation of the secured creditor could expose all such lenders to CERCLA liability for engaging in their normal course of business.

Does EPA still support the interpretation of the Superfund Act advanced by the Government in that case?

Mr. STROCK. Senator, I know you'll understand that that case is still in litigation at the present time. A rehearing is being sought. So I would like to defer specifically responding to that part of your question.

But, I would like to address it in a broader way, if I might, sir.

It is clear that the statute, as the Congress drafted it in 1980, does have a security interest exemption. And it's also clear that one of the policy judgments that Congress made in that exemption was that it was in everyone's interest—the banks and those who were concerned with environmental protection more generally—that lenders not become so fearful of protecting their collateral short of foreclosure that they would be discouraged from protecting the environment during the maintenance of the loan itself.

So I think the point you've raised is a very important one and it's one that we need to be cognizant of.

Senator GARN. Let me ask you just a very general question.

Take your EPA hat, your legal hat off, whatever hat you've got. Do you think it's fair? Do you think it makes any sense at any cost to try to get somebody if they had nothing to do with it, like the example—you were here. You heard what I said—do you think it's fair for that bank to end up with the building and all the liability? The guy that bought the dealership is fine. He was smart enough to say:

I'm not going to buy the building and the land. I'm going to build a new building some place else.

Do you really think that's fair? Or Congressman LaFalce's statement about the guy that had $100,000 put in it and got charged $2 million?

Mr. STROCK. Before I take my EPA hat off, you'll understand that I cannot respond to the particular matter that you mentioned—the real life case here today.

Senator GARN. I am just asking you if you think those sorts of situations are fair.

Mr. STROCK. Clearly, a situation where a lender had absolutely no involvement in the practices alleged to cause the contamination, there would be a very real fairness question.

I think you will find that the cases do not all go as far as the *Fleet Factors* case you referenced. And that, in other cases, there is a much closer linkage to situations where the bank or the lender actually became an owner or operator in a more common sense sort of way.

## OPENING REMARKS OF SENATOR D'AMATO

Senator D'AMATO. Mr. Chairman, if I might, I have another hearing, and I'm going to ask my good friend from Florida to bear with me, and the chairman, as well.

Mr. Strock, let me tell you something. I understand it's great to be for the environment, and we're all for the environment. But let me tell you, if you want to put little people out of business and make sure that the guy, for example, who needs desperately a loan, can't get one, I'm talking about a farmer, all right, I'm talking about a gasoline station attendant, I'm talking about a repair facility, a dry cleaner, and you can go into just dozens and dozens of small businesses, then don't support this legislation, continue going on this jackass policy, don't seek to clear it up, don't talk to anybody. You take the high road: I'm for the environment.

Now, that's great. It makes great publicity. The tougher you are for the environment, boy, I'll tell you, in the polls, that's great. But

this is practicality. We have got a credit crunch in this country that's incredible. You're just adding to it, you're exacerbating it, and it's ridiculous. We need some reform. You make the niceties about, well, they should have known. A guy forecloses and he finds out he's got an environmental mess on his hands. You can't hold him responsible. Fairness, common sense.

Now, maybe you're a rich millionaire, you know, and you come in here and you donate your services to the Government, you know, and that's great. And you don't have to worry about this. But most people aren't; they've got to go out in the real world and make a living. And they pay the taxes. So, I want to tell you something. On the altar of politics, all right, and you just continue that frame over there, somebody was chuckling when the Senator tried to get an answer from you, and I join in it.

Mr. Chairman, I support your legislation. If there are some additions, amendments or safeguards that need to be made, I know the chairman would be the first to say, we're willing to do it. Let's make sense. But let's do it, let's protect the environment, but let's not place an undue burden on unsuspecting lenders, et cetera, and just put such a chilling effect. I'm going to ask that my full statement be put in the record.

I want to commend you, Mr. Chairman, for what you're doing. Please continue on because I'll support you in any way possible. And I thank my friend and colleague from Florida——

Senator GARN. Without objection, your full statement will be placed in the record. We, all of us had a hard time understanding what the Senator from New York's statement is.

Mr. STROCK. Sir, may I respond to one accusation, that I'm a millionaire? [Laughter.]

I'm not.

Senator D'AMATO. That's good, because when you go in the real world, you're going to find out that this kind of craziness we have here will keep you from even being a businessman. [Laughter.]

And possibly become that someday.

Mr. STROCK. Senator, if I could also say, I regret that you were not here for my statement, because I wish to indicate very strongly that EPA is not only willing, but very ready, to work very quickly at clarifing issues that require reasonable clarification in this area.

Senator D'AMATO. Are you going to support this legislation?

Mr. STROCK. Not at this time.

Senator D'AMATO. Why?

Mr. STROCK. Because it has many implications we think need to be looked at carefully. It requires a full interagency review.

Senator D'AMATO. How long will that take?

Mr. STROCK. We're looking at this autumn having it completed.

Senator D'AMATO. How many more businesses won't be able to get loans? That's next year. How many more people are going to be placed on the head of the pin? How many more people are going to have to go through this incredible torturous procedure, and how much more moneys are going to have to be wasted, and how much more litigation, because they're going through that tortuous procedure.

I would just suggest, you know, that the American people need some relief, and little guys, farmers, innocent people, small bank-

ers who want to help them but who are afraid. What the hell; you've got to be nuts, as a lender today, in vast areas, to make any kind of loan, vast areas throughout the economy, you're going to be held liable. It doesn't make sense.

Please. I'm going to leave. [Laughter.]

[The statement of Senator D'Amato follows:]

## OPENING STATEMENT OF SENATOR D'AMATO

Senator D'AMATO. Mr. Chairman, a credit crunch is devastating many farmers, small businesses, contractors and manufacturers. This credit crunch is different, because it is not based on economics or interest rates. Instead, lenders are refusing to lend any amount at any price if they suspect that a property might be contaminated with hazardous waste.

The reason is that the lender, rather than the owner or borrower, can be held responsible for the full cost of cleaning up a hazardous waste site. The cost of such a cleanup may run into the millions of dollars.

The problem stems from a series of court decisions that have reversed the intent of Congress in enacting the Comprehensive Environment Response Compensation and Liability Act (CERCLA) which we all know as Superfund. Congress originally included protection in the law that insulated innocent lenders from liability for hazardous spills. Lenders have been shocked by court decisions that have held lenders responsible for the full cost of cleaning up hazardous waste, even if the lender in no way caused or contributed to the contamination.

Cleanups of this sort can be very expensive, easily running into the millions of dollars. Lenders therefore not only risk losing the amount of their loan, but face an open-ended liability for cleanups that can exceed the value of the property.

CERCLA contained three provisions that were intended to protect lenders from liability for releases of hazardous substances by their borrowers. The first proviso exempted from liability a person "who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest." In other words, if a lender merely collateralized a loan with a lien on property he would not be liable.

The second lender protection in the Superfund law is called the "Innocent Landowner" defense. If a lender can show that the property was acquired after the hazardous substance was placed there, and that the lender did not know the property was contaminated after making reasonable inquiries in the previous uses of the property, the lender is not liable.

Finally, Congress provided that if the release of a hazardous substance was caused solely by "an act or omission of a third party" the lender is relieved of liability.

Clearly, Congress intended to exempt innocent lenders from liability. On the other hand, if a lender was in fact responsible for contamination, the lender should have the same liability for cleanup as anyone else.

The number of businesses affected by this situation is very large. Every farmer uses pesticides, fertilizers, and fuels. Every gasoline station, auto dealer, and trucking company has fuel tanks and handles waste petroleum products. Dry cleaners, metal finishers, chemical manufacturers, paint stores, and many other businesses all use hazardous materials of various sorts.

Let me cite two examples from New York State of the impact of CERCLA on lenders.

An upstate New York Farm Credit Association foreclosed on a large fruit farm. Later, they discovered that pesticide had been stored in a building with a leaking roof. Before the farm could be sold, the association had to spend $60,000 to remove and dispose of soil from the barn floor and other tainted material. In addition, the association has established a reserve fund of $200,000 just in case additional cleanup is required, even though the property has been sold.

In another case, the Marine Midland Bank was asked to make a $50 million loan to finance the acquisition of a western New York company that is an industrial solvents manufacturer and metal processor. Because of potential CERCLA liability, the bank thought an environmental audit was necessary. However, the buyer refused to pay the $250,000 cost of an audit, and the deal fell through. The bank missed out on the interest, fees, and related business the transaction would have produced.

In order to protect themselves, lenders are increasingly requiring environmental audits before they make loans. These audits can be quite expensive, and obviously add to the cost of borrowing, since the borrower must pay for them. An initial environmental assessment usually costs about $1,500 to $2,000. If that preliminary check indicates the presence of contamination, a thorough audit can routinely cost up to $150,000 or more.

Private lenders are not the only parties that can be found liable under these court interpretations. Governmental agencies, such as the Small Business Administration or even State guaranty agencies can be held liable. I am certain that Congress did not intend that.

Furthermore, liability under CERCLA may extend not only to a lender, but to a trustee or fiduciary who holds title to or controls a property that is contaminated as part of a trust or estate. Thus, if a bank trust department accepts an assignment to administer an estate, the bank could find itself liable for the full cost of any necessary environmental cleanup. Congress surely never intended that.

This is a crisis that need never have happened. It certainly was never the intention of Congress to create such a situation. It is a problem that cries out for prompt resolution.

Fortunately, my colleague, the Senator from Utah, Mr. Garn, has introduced S. 2827, the Federal Deposit Improvements Act of 1990, which contains provisions that restore the original intent of the Superfund legislation, and will restore the confidence of lenders to make loans to deserving and creditworthy borrowers.

Let me stress that this legislation protects innocent lenders who are not responsible for hazardous spills. But if a lender is indeed responsible for contamination, he is held to the same standard of liability as any other polluter. I think that is fair and right.

The other provisions of this bill address deficiencies in FIRREA that have been identified by the FDIC. Some of these have merit and others may require additional scrutiny. However I do believe that it is important to look at what we can do this year to ameliorate some of the more glaring shortcomings of FIRREA. Nevertheless, I am a cosponsor S. 2827, and I look forward to its speedy passage.

Thank you, Mr. Chairman. I yield the floor.

Senator GARN. My time is up on this one. [Laughter.]

Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman.

The line of questions that Senator D'Amato has just been asking inferred that EPA has a range of administrative discretion that it has not exercised which, if exercised, would give some relief in the cases that Mr. Seelig outlined.

Is that your interpretation of the law?

Mr. STROCK. We do indeed have some administrative flexibility, and it has been used. I think a key factor here, again, is that the cases that have been brought to date reflect, upon examination, that there are situations where lenders have, in a common sense perspective, become owners and operators under the statute itself.

Having said that, it's very clear from many of the points raised—and not just today, because I would add, this is not something that just came up for the first time today—that the Government has a very strong obligation to make certain that its enforcement actions in this area are consistent. That is the reason for the "secondary liability" study that the Department of Justice is presently beginning with the EPA. I should add, Senator Graham, that the goal is to have a report back to this committee by October 15 from that review.

Senator GRAHAM. Mr. Seelig, it's been indicated by Mr. Strock, that the current exemptions that exist in the law, such as the secured creditor exemption and the innocent landowner defense, could you tell me why those two are not sufficient to cover reasonable cases where fairness would argue for special treatment?

Mr. SEELIG. Senator Graham, there are a couple of reasons. One, that while Mr. Strock indicated that EPA has discretion, they may not sue the FDIC or RTC for the lender, directly; they may sue a third party that's responsible for the cleanup. That party can then file suit to try to recoup some of the moneys that it owes EPA, and we get dragged into the same suit. As a result, we're on the hook there.

Second, to answer more directly your question——

Senator GRAHAM. Excuse me. Could you give me an example of that situation that you described?

Mr. SEELIG. An example of that type of situation would be EPA sues somebody who, in the current ownership—in the direct testimony, there was an example we submitted of a bank that failed in 1973. U.S. National in San Diego. In 1989, EPA sued the current owner of the piece of property for environmental cleanup. That party, in turn, started suing anybody who had been in the chain of title, looking to recoup some of those moneys. The FDIC had indemnified the assuming bank which had held the title, as a trustee for an employee retirement fund, for a very brief period of time, so we

were dragged into the suit. This property was polluted back in the 1950's, so we're talking about a substantial period of time.

But you can have a situation where EPA can go after the party that caused the problem, and they can go after anybody else in the chain of title.

Senator GRAHAM. Assuming that the innocent landowner defense had been in effect during the pendency of these various actions, what defense would it have afforded?

Mr. SEELIG. The innocent landowner defense has some benefits. It gets into the whole area of judicial interpretation. The key issue is that you acquire the property after the hazardous substance was dumped. This should afford a fair amount of protection. But for FDIC and RTC it doesn't always, because the failed institution may have acquired a piece of property that has drums on it that are currently draining. We don't have a choice when the institution fails; we take over what's there and we're stuck with it.

Senator GRAHAM. Let me ask the question, do you believe that if a depository institution forecloses on a piece of property and, to use the language of the innocent landowner defense, they fail to undertake appropriate inquiry into the previous ownerships' uses of the property, consistent with good commercial and customary practices, in an effort to minimize liability, if they fail to do that and therefore did not have the advantages of the innocent landowner defense, do you think they ought to be given a permanent Federal protection?

Mr. SEELIG. I think the issue is, when they made the loan, should they have exercised due diligence. And the courts are finding that they can be held liable subsequently. I think that's part of the issue.

The concern is, you're right, a lender should have to undertake due diligence in order to know what they're lending on. I don't think anybody would argue differently. But to hold the lender subsequently liable——

Senator GRAHAM. Excuse me. As I understand it, and I don't have the full text of the law, I have a summary, the innocent landowner defense applies to the liability of an entity after it has acquired the property. This is not unsecured credit. You've acquired the property in an after-the-fact situation, and it stipulates under what conditions you can raise the innocent landowner defense as a bar to liability.

My question is, why is that, in conjunction with the secured creditor exemption, not an adequate defense for a depository institution?

Mr. SEELIG. Because, and I'm not an attorney, but it's been explained to me that the problem is that now the lender, years later, has to make a decision as to whether to foreclose to try to recover on the collateral, and now, they're faced with a decision of having to go through it and do due diligence. And, moreover, the courts will determine what is sufficient due diligence to provide them with that defense. There's always the uncertainty that no matter how much they do, if they then take title to that property and then find out there was a problem even though there was no problem when they made the loan, they're stuck with the cost of cleanup, not just with what they lost on the loan.

Mr. MIAILOVICH. If I made add to that, on the supervisory side, it's dangerous. The danger is not that much with the wording, it's the way it's operated, the ambiguities in the actual operation of that. It could in fact, if you want to assert that defense, you would have to expend a tremendous amount of money in legal costs, even if you're not certain how it's going to be interpreted. So why even get involved in the first place. So you in fact because these people are restrained from even getting involved to start with, the defense makes sense but it's mighty hard to prove in reality.

Senator GRAHAM. Excuse me. I know my time has expired.

Senator GARN. Senator, there are only two of us here. Please go ahead and complete your questions.

Senator GRAHAM. I'm concerned that we're hitting, with a very big axe, a problem that maybe requires a sharpened scalpel. For instance, you're not only proposing in this legislation, and you suggest that it should be even more explicit than I think it is already, that is, this is going to override State laws as well as Federal laws, I know a number of States which are very concerned about things like chemical spills, oil spills, and a number of them have strict liability on vessels that are found to have engaged in those activities. Are you telling me that if a ship, which has been foreclosed upon and is now owned by a depository institution and is in the port of Tampa, and that depository institution has not been able to raise the innocent landowner defense relative to that vessel, that is; it did not undertake at the time of acquisition an appropriate inquiry, that it could have even known that chemicals were on board, and those chemicals pollute Tampa Bay, that that vessel owner depository institution should be exempt from the State law of strict liability?

Mr. SEELIG. No, Senator, that's not what we're saying. If in fact the ship is owned by the financial institution at the time that it pollutes, or if it is owned by the FDIC at the time it pollutes, we believe we should be held fully culpable. What we are saying that if the ship polluted 3 years earlier, that it is unfair to now hold the lending institution liable for the cost of the cleanup for an action that occurred prior to its ownership.

Senator GRAHAM. I'm quoting the bill, S. 2827, on page 9, beginning on line 18, which is the operative paragraph. It says:

> No insured depository institution or mortgage lender shall be liable under any law imposing strict liability for the release, threatened release, storage, or disposal of a hazardous substance or similar material, from a property, (1) acquired through foreclosure, (2) held in a fiduciary capacity, or (3) held, controlled, or managed pursuant to terms of an extension of credit.

In my example, a depository institution or a mortgage lender had loaned money on a vessel. They foreclosed on that vessel. They now have title to it. It is in the port of Tampa. They know that it has hazardous chemicals aboard. They have not made any efforts to see that those chemicals are handled in appropriate ways, and therefore they do not have a currently available innocent defense. That vessel pollutes Tampa. Under Florida State law, strict liability, they should have to clean it up.

You're telling me that under that exemption, they would not be precluded from the application of Florida's strict liability law? If so, how do you interpret it to get that result?

Mr. SEELIG. Senator, on page 10, there's a section, which has the exclusions to the exemption, that I believe would require the lending institution to have to make those payments.

Senator GRAHAM. Which exclusion from the exemption do you think would apply in this case?

Mr. SEELIG. Depending on the situation, either (1) or (2).

Senator GRAHAM. How would those exclusions be different than those exclusions which are available under the innocent landowner defense?

Mr. SEELIG. The innocent landowner defense protects you if you can meet those tests with respect to claims for pollution or environmental damage prior to your taking ownership. I think that's where the distinction is. If the lender foreclosed on the ship, and if the ship had polluted 5 years earlier in the Port of Tampa, the question is, should the lender now be responsible for paying any of the costs that were associated with the cleanup 5 years earlier. Then the test becomes, can they meet the innocent purchaser test. And the costs of meeting that test to protect yourself from claims for prior incidents is what we're concerned about.

We're not requesting, and I don't believe this legislation is attempting to provide protection to us or to any lending institution for pollution or environmental damages. Our concern is more with being hit for cleanup costs for damages that occurred prior to the ownership and were caused by other parties, unless I'm misinterpreting the bill.

Senator GRAHAM. If that's the intention, I think the language is written more broadly than that.

I'm also concerned, as a matter of policy, of extending this to State laws. And particularly, we're talking here about depository institutions and mortgage lenders. Assuming that the insured depository institution were a Federal depository institution, I can see some case being made for overriding State law, based on the premise that they are insuring both State and Federal-chartered institutions. That would be an arguable case.

What do you think is the case for extending a general exemption to mortgage lenders to be sheltered from State strict liability laws.

Mr. SEELIG. The FDIC is obviously concerned with the institutions that we insure; not the ones we don't. But I think from a broader perspective, while there are many uninsured originators of mortgage loans, many of those loans end up in federally insured entities ultimately as investors. Most mortgage originators, such as mortgage bankers, don't hold mortgages for their own portfolio, but face the same risk and the same disruption, as insured originators. If you're a mortgage originator, whose sole purpose is to originate mortgages which you then place with Fannie Mae, Freddie Mac, Ginnie Mae, or whomever, and all of a sudden, you know, for a fee of a couple of hundred dollars, and maybe your only income is a small service fee on that loan, you're all of a sudden going to be tagged for very substantial liabilities, you've now got a large risk. That I think has some implications for the availability of credit in this country.

Senator GRAHAM. Sufficient to override the judgment of 50 States and their collective State policies.

Mr. SEELIG. On that issue, I'm not quite sure, sir.

Senator GRAHAM. Thank you.

Senator GARN. Thank you, Senator Graham.

May I just make a comment about your questions. It's certainly not the intent, as I explained in my opening statement, for this legislation in any way to exempt anyone who has knowledge and who has not taken due care and all of that. If the language is not precise enough, I always brag about not being an attorney, certainly if there are technical changes that need to be made to make certain that that is clear, I have no objection, no pride of authorship. The reason we did put in the exemptions, and I'm not going to go through them, on page 10, was certainly only to protect the innocent victims in foreclosures who in no way had been involved. There was no attempt by anyone to try and protect those who do have some blame, knowledge, didn't do their due diligence, et cetera. So the intent is certainly along the lines of your questions, Senator.

Let me get back to this innocent landowner exemption. As I understand it, it isn't a question, Mr. Strock, that that is there. We had Congressman La Falce's testimony about congressional intent, and no one yet has disagreed with the fact that that is what Congress intended. It was very deliberately thought out. The record is clear.

Some courts have decided otherwise, and that is the nature of our problem. If we were still back to where we were with the intent of the innocent landowner defense, and we're not trying to change that, we're trying to get back to what the intent was and make certain that everybody knows that. But in reading from some other legal scholars, they point out the problem. And I'm sure, Senator Graham, you'd be interested in this.

Problems in establishing the defense are not just the amount of money involved. First, if the party finds out about environmental problems after the loan is made, so they've made a loan innocently not knowing of them, but before actual foreclosure, then the innocent landowner defense doesn't apply. So they made the loan, they didn't know about the problem, they find out about it, but they haven't yet foreclosed, then the lender can't use the innocent landowner defense.

But on the other hand, here's the catch 22. If the party does not make an appropriate inquiry prior to foreclosure, it cannot use the innocent landowner defense. So if you haven't foreclosed and you're in that middle ground, and you say, hey, we found this out, then the defense doesn't apply. However, if you don't find out about the problem, they say, hey, you didn't do your due diligence, so it's still your fault.

So there are some real problems with the interpretations of that innocent landowner defense, compared to the exemptions that Congress tried to apply at the time.

Mr. Seelig, either one of you, is that an accurate description of some of the problems?

Mr. SEELIG. Yes, Senator, it is.

Senator GARN. Mr. Strock?

Mr. STROCK. Yes.

Senator GARN. Again, if there's some way we can get back to clarifying these, it doesn't have to be my bill. There are other ways to do it.

Mr. STROCK. Senator, if I could add, I do think many of the issues that you and Senator Graham have raised obviously are very important issues. And they reflect, from EPA's point of view, the need for EPA to work very hard to clarify the law as currently written and applied. Again, we intend to do that.

Senator GARN. Senator Graham, do you have additional questions at this time?

Senator GRAHAM. I do not.

Senator GARN. I have several pages of additional questions, but a lot of them are technical in nature. What I'd like to do is submit them to you for your response in writing back to the committee.

Thank you very much for your testimony.

I'd like to invite the second panel up. Charles Mitschow and William Roberts. If those who are leaving could expedite as soon as possible, we would appreciate it.

Mr. Mitschow, please begin.

## STATEMENT OF CHARLES M. MITSCHOW, REGIONAL PRESIDENT, MARINE MIDLAND BANK, BUFFALO, NY, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. MITSCHOW. Mr. Chairman, members of the committee, I'm Charles Mitschow, regional president of Marine Midland Bank in Buffalo, NY, and a past president of the ABA's Small Business Banking Committee.

I welcome the opportunity to present ABA's views on the critical issue of environmental lender liability, its effect on the banking industry, and Senator Garn's bill, S. 2827, which was introduced to remedy this problem. Specifically, we support Senator Garn's provisions on environmental liability because they will rationalize the lending process that the courts have distorted by expanding liability. Unless some changes are made to current law, major segments of the business community, particularly small business, will not be able to receive adequate financing when purchasing property, which presents environmental risks, or when using such property as collateral. Furthermore, this reluctance to lend will reduce the capital available to businesses which want to protect or restore the condition of the environment. In addition, the ability of businesses, their owners, and others to use bank fiduciary services will be severely curtailed.

It is critical to understand clearly that this is not just a lender problem, this is a major problem for borrowers, businessmen, farmers and homeowners as well as the Federal Government. It is critical to understand that, as each month goes by, the problem is going to grow, as lenders learn more about their liability and come in and ask for loans. Both lenders and borrowers have expressed dissatisfaction with the current provisions of and decisions under Superfund.

From the lender's perspective, possible liability for multimillion dollar damages has greatly increased the risk of doing business. Even when the lender is not held for the record responsible, such

liability creates credit risks by reducing the borrower's ability to repay the bank and by impairing the value of the collateral.

Mr. Chairman, I testified last year before the House Small Business Committee on the crisis in small business lending, due to the concern about environmental liability. Since that time, there has been a groundswell of support for the restoration of congressional intent for lender responsibility under Superfund. Business groups have joined together with over 250 Members of the House who have cosponsored that bill.

The incredible decision in Fleet Factors has dramatically raised the stakes for the U.S. economy. A recent ABA poll of the Association's Community Bankers Council, those banks who have assets of $250 million or less, have found that 43 percent of the respondents have already stopped making loans altogether to certain types of small businesses, those most frequently associated with environmental problems, and another 11 percent plan to do so shortly. This is just the beginning. More and more lenders are learning of the dangers they face, and are now reacting. I can assure you that soon, whole categories of businesses, businesses central to our economy, will basically be cut off from affordable financing, particularly after the ramifications of the *Fleet Factors* case are fully understood by the industry.

The risk of the decreased value of collateral, coupled with the potential enormous liability, has forced not only caution on the part of the lenders but, as Congressman John La Falce points out, the willingness of lenders "to provide financing to businesses located generally in an area where the possibility of hazardous waste contamination exists, even if there is absolutely no showing that a specific property owned by a prospective borrower or any adjacent property were contaminated." As a matter of fact, Mr. Chairman, banks are learning that they can't afford to lend at all to certain types of small businesses, such as chemical companies or small dry cleaners, because of the environmental liability.

Another major concern of banks for environmental liability is in the trust area. The ABA strongly believes that banks should not be burdened with the liability for cleanup of hazardous substances on land, merely because they hold title in a fiduciary capacity. Consider the following:

A bank may be an executor and perhaps a testamentary trustee of a decedent's estate. Included among the assets is a piece of real estate that, years before, may have been the site of a landfill or a mine, long since shut down. It's later discovered that chemical pollutants remain on the property.

The bank didn't cause the problem. Perhaps the decedent didn't cause the problem. The polluter could have been a prior owner. Nevertheless, the bank, as current owner, would be liable for the total cleanup, even beyond the assets or the estate or trust.

As a result of CERCLA's strict liability provisions, and in an effort to protect themselves from such liability, bank fiduciaries have become reluctant to accept appointments for certain trusts.

The ABA believes that Senator Garn's proposal would not fundamentally change CERCLA but rather restore its original intent. The Association believes that it was the intent of Congress to ex-

clude innocent lenders from liability, but the court interpretations have totally undercut that intent.

Most of the litigation involving commercial lenders under CERCLA focuses on two aspects of the lender's relationship to the borrower. Such suits attempt to show that the lender is the owner or operator of the property where the cleanup costs have been incurred. The typical fact pattern involves a lender who finances a business borrower and takes a security interest in real property.

We believe that the Court of Appeals in the *Fleet Factors* case has now established a new and even broader standard for the lender. This case holds that, despite the explicit exclusion in the Superfund law for lenders who hold a security interest in property, it may be inferred from the nature of their financial relationship with the borrowers that such lenders are owners or operators of property and thus liable for cleanup.

The decision in this case holds that a lender with the "capacity to influence" a borrower's hazardous waste management decisions, becomes liable for cleanup costs and other damages under CERCLA.

Mr. Chairman, the impact of Fleet Factors on the lending community is painfully obvious. The eleventh circuit is sending the message that prudent lenders should not continue their time-honored effort of being active in assisting a borrower during a troubled period because, if they do, they will be liable for any pollution cleanup costs. Lenders will now be safer taking a complete hands-off approach and ignoring their security interest in the facility or real estate that serves as collateral.

The ABA also recognizes the exposure faced by the agricultural community in the environmental area. The businesses affected in the agricultural community are extensive and comprise such as feed lot operations, grain elevators, co-ops, fertilizer and chemical dealers and suppliers, poultry operations, meat packing and rendering facilities, cattle ranches, hog production facilities and traditional crop operations may all generate, use or dispose of hazardous materials or generate other wastes hazardous to the environments.

Since lenders often make loans secured by residential properties, any of those properties located near landfills or other environmentally hazardous areas, will also be a cause of great concern to the financial industry.

Superfund liability is not only a private sector concern. Several Government agencies have acknowledged the threat that they face from the broad scope of CERCLA. The RTC has acquired tons of houses and properties from failed S&L's, and is currently attempting to determine which of these loans might present an environmental problem. The SBA, in testimony before Congress, has stated that it potentially faces CERCLA liability when it guarantees small business loans.

Mr. Chairman, I'd like to at this point address some of the concerns that have been raised about the various legislative proposals. Quite frankly, the ABA believes that these concerns are either invalid or vastly overstated. One concern that is sometimes raised is that if legislation, such as this proposal, is enacted, lenders will no longer have the incentive to perform environmental audits. While

it's not clear to the ABA why lenders should be required to be the detectives assigned to ferret out environmental problems, the truth of the matter is that lenders do have a tremendous incentive, even after the passage of legislation along the line of this bill, to continue and even expand the practice of performing environmental audits on properties on which they are lending. The reason for this is quite simple: if the property is polluted, the lender stands to lose the entire value of the loan. Even further, it puts the borrower in jeopardy for the ability to repay, if he has the cost of the cleanup.

Therefore, I can assure the committee that lenders will continue to perform environmental audits and rightly or wrongly serve as the detective.

Another concern that's been raised is that the lenders may obtain windfall profits in the case where the lender forecloses on property which is then cleared up by the EPA. It is our reading of the bill that such a windfall profit would be prohibited, and it is not the intention of the ABA to seek the capability to receive such windfall profits. The cleanup work paid out of Superfund will not in any way benefit the lending institution.

CERCLA has become a trap to the lending community, with widespread negative economic implications. It is not only lenders which face threats to their economic health. A wide range of businesses, including service stations, dry cleaners, high tech manufacturers, industrial concerns, and agriculture, are paying, and will continue to pay the costs of imposing environmental liability on lenders.

We urge Congress to move as expeditiously as possible to enact legislation along the lines of this bill.

I'll be happy to answer any questions you may have.

[Complete prepared statement of Charles M. Mitschow follows:]

STATEMENT

OF

THE AMERICAN BANKERS ASSOCIATION

ON

THE LENDER LIABILITY ACT OF 1990

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

BY

CHARLES M. MITSCHOW

JULY 19, 1990

Mr. Chairman and members of the Committee, I am Charles M. Mitschow, Regional President of Marine Midland Bank in Buffalo, New York. I am a past member of the American Bankers Association's Small Business Banking Committee. The combined assets of ABA members comprise approximately 95 percent of the total assets of the commercial banking industry. While our members range in size from the smallest to the largest banks, some 85 percent have assets of less than $100 million.

I welcome the opportunity to present ABA's views on the critical issue of environmental lender liability, its effect on the banking industry and Senator Garn's bill (S. 2827), which was introduced to remedy this problem. Specifically, we support Senator Garn's provisions on environmental liability because they will rationalize the lending process that the courts have distorted by expanding liability. Unless some changes are made to current law, major segments of the business community, particularly small business, will not be able to receive adequate financing when purchasing property which presents environmental risks or when using such property as collateral.[1] Furthermore, this reluctance to lend will reduce the capital available to businesses

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[1] See, Matusik, Environmental Cleanup Liability Makes Banks Leery of Lending, Investor's Daily, July 27, 1989.

which want to protect or restore the condition of the environment. In addition, the ability of businesses, their owners, and others to use bank fiduciary services will be severely curtailed. Therefore, we urge support for subtitle B of S. 2827 and a similar bill pending in the House (H.R. 4494).

It is critical to understand clearly that this is not just a lender problem, this is a major problem for borrowers, businesses, farmers, and even homeowners. And it is critical to understand that as each month goes by, the problem is going to grow and grow as lenders learn more about their liabilities and as the potential borrower comes in and asks for a loan.

Let's look at a hypothetical. Suppose a gas station owner asks a bank for a $50,000 loan. It might even be for a loan to clean up around the station's storage tanks. The collateral for the loans would almost always be the gas station, itself. An environmental study -- paid for by the station owner -- would be required. This could cost from $500 to $2500 -- a very stiff expense. But even with a clean result from the study, would the bank make the loan? Increasingly, the answer is "no!" Why? The study is not foolproof and therefore the bank is still at risk, first, that its collateral is worthless and, second, that if it has to foreclose, it could face cleanup costs many times the

value of the loan. Simply put, why would any lender risk, potentially, hundreds of thousands of dollars of liability over a loan in which it might make a profit, if all goes well, of a thousand dollars or so? Can a bank justify such a risk to its shareholders -- or to its regulators?

Now take this hypothetical and apply it to all types of businesses using chemical products, petroleum, fertilizers, pesticides, etc.... It should not be hard to see that this growing problem will have a dramatic impact on whole segments of our economy. One other hypothetical -- suppose the gas station owner (or the dry cleaner, or auto repair shop, or fertilizer distributor) wants to sell his or her business. How is the purchaser going to obtain a loan to buy it when the collateral for the loan would be business property?

## History of the Problem

### Overview

Since the passage of the federal Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), 42 U.S.C. 9601, et. seq., known as "Superfund," financial institutions have faced the possibility that their security interest will be impaired and their potential for liability increased if hazardous or toxic materials are

discovered on premises whose purchase the bank has financed through a mortgage loan on which the property serves as collateral.[2]

CERCLA provides for strict, joint and several liability for the cost of removing and remedying a release or threatened release of hazardous substances and for harm to natural resources caused by such release. 42 U.S.C. § 9607(a).[3] This means that the person bringing an action is not required to prove the defendant acted negligently and that one person can be forced to pay for the entire amount of damages even if other defendants are also found to be responsible. A party will be held liable when it is proven that:

(1) a release or threatened release of a hazardous substance exists;

(2) response costs (e.g. cost of removing the hazardous material) were incurred as a result of the release;

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[2]See, Brown, Superfunds and Superliens: Super Problems for Secured Lenders, BNA's Banking Report, April 14, 1989.

[3]See, e.g.; State of New York v. Shore Reality Corp., 759 F. 2d 1032 (2d Cir. 1985).

(3) the person falls into one of the four categories of responsible parties outlined in the Act (i.e., current owner and operator of the facility, any former owner or operator of the facility at the time of the disposal of a hazardous substance, a transporter of hazardous materials or a generator of hazardous wastes). (§ 9607(a))

Holding lenders liable for cleanup costs caused by their borrowers' misdeeds is having a tremendous negative effect on commercial lenders and others who use real estate as collateral. Both lenders and borrowers have expressed dissatisfaction with the current provisions of, and decisions under, CERCLA.[4] From the lender's perspective, possible liability for multi-million dollar damages has greatly increased the risk of doing business. Even where the lender is not held directly responsible, such liability creates credit risks by reducing the borrower's ability to repay the bank and by impairing the value of the collateral. Prudent lenders are now requiring borrowers to obtain environmental audits (i.e., examination of public records and the property itself to determine whether hazardous substances are present) as a condition for granting a loan. At best, many borrowers are facing greatly increased loan

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[4]See, Hearing on The Impact of Superfund Lender Liability on Small Businesses and Their Lenders, Before the House Committee on Small Business, 101st Cong., 2nd Sess. (June 7, 1990).

transaction fees as a result of the lending community's reaction to CERCLA. There are, however, borrowers engaged in certain types of commerce who are finding it difficult to obtain financing because lenders are reluctant to take on the environmental risk.[5]

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[5] In a 1989 Circular from the Federal Home Loan Bank System, the Office of Regulatory Activities outlined eight (8) basic categories of risk to financial institutions from environmentally contaminated property. These include:

1. The risk that the collateral for a real estate loan or property to be acquired may be drastically reduced in value after discovery of the existence of hazardous waste contamination.

2. The risk that the borrower cannot repay the loan if the borrower must also pay for the cost of cleaning up the contaminated property. The cost for cleanup in many cases can be significant and may exceed the institution's encumbrance on the property.

3. The risk that a mortgage loan may lose priority to a cleanup lien imposed under the laws of those states that require super priority liens for the cost of cleanup. In each of these super lien states, a lien granted to the state securing the cost of cleaning up hazardous waste contamination may have priority over a lender's mortgage.

4. The risk that a lender may be liable to the extent of any credit extended to any debtor who has operated property containing hazardous wastes, has generated such waste, or has transported it in an improper manner. This risk extends to all creditors, not just those who hold as collateral the property containing the hazardous waste.

5. The risk that the bank may become directly liable for the cost of cleaning up a site if it forecloses on a contaminated property or becomes involved in the management of a company that owns or operates a contaminated facility, or is involved in decisions pertaining to the disposal of toxic or hazardous waste.

6. The risk that a lender may not be able to pursue its foreclosure remedies and may have no practical alternative

(Footnote Continued)

A recent ABA poll of the Association's Community Bankers Council (whose banks have assets of $250 million or less) found that 43 percent of the respondents have already stopped making loans altogether to certain types of small businesses most frequently associated with environmental pollution and that another 11 percent plan to do so. This is just the tip of the iceberg. More and more lenders are learning of the dangers they face and are now reacting. I can guarantee that soon whole categories of businesses -- businesses central to our economy -- will basically be cut off from affordable financing, particularly after the ramifications of the Fleet Factors case are fully understood by the industry.

After the loan is made, CERCLA also presents problems for lenders who are considering whether or not to foreclose on real property. While prudent practice may dictate that a bank foreclose on collateral which secures a defaulted loan, the threat of Superfund liability often requires the lender

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(Footnote Continued)
but to give up its loan security, and the right to recover on the loan itself. This could lead to charging off the loan balance.

7. The risk that the borrower does not maintain collateral or property with an environmental risk potential in an environmentally sound manner.

8. The risk that, aside from the statutory liabilities that can be imposed for toxic waste contamination, there is also potential liability for personal injury or property damage.

to perform an audit of the property and -- in some cases -- walk away from the contaminated property. The difficulties faced by those who hold property in a fiduciary capacity may be even more severe. In many cases the trustee will have no specific knowledge of the nature of the property which is the subject of the trust until the trustee's fiduciary duties become operative. The most common circumstances in which a bank acting as fiduciary may hold real property include: 1) as executor of an estate, sometimes with property flowing into a testamentary trust; 2) in a pension fund which may hold title to a plant or office building; and 3) under a bond indenture in which the bank represents the bondholders and may need to foreclose or exercise other rights over property held as collateral in the event of default.

As S. 2827 clearly recognizes, Superfund liability is not only a private sector concern. Several government agencies have acknowledged the threat they face from the broad scope of CERCLA. The Resolution Trust Corporation (RTC) has acquired tens of thousands of properties from failed savings and loans and is currently attempting to determine which of these might present environmental problems. The Small Business Administration, in testimony before Congress, has stated that it potentially faces CERCLA liability when it guarantees small business loans. Even the residential lender has become wary of lending to prospective

homebuyers. Properties adjacent to commercial manufacturers or pesticide-contaminated farm land are being turned down for financing.

Due to court interpretation of CERCLA, there is a new philosophy of environmental enforcement that has made lenders increasingly wary of the risks inherent in loan transactions secured by property containing hazardous substances. The risk of decreased value of the collateral for a loan, coupled with potentially enormous liability under CERCLA, has forced not only caution on the part of lenders but, as Congressman John LaFalce points out, the unwillingness of lenders "to provide financing to businesses located _generally_ in an area where a possibility of hazardous waste contamination exists even if there is absolutely no showing that the specific property owned by a prospective borrower -- or any adjacent properties are contaminated."[6] As a matter of fact, Mr. Chairman, banks are learning that they cannot afford to lend at all to certain types of small businesses (such as chemical companies) because of environmental liability.

As the Tampa, Florida _Tribune_ so aptly put it in an editorial entitled, "Misplaced Environmental Blame:"

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[6] Cong. Rec. E1325 (April 25, 1989).

It seems incredible, but in the United States you can be held liable for something you didn't do, didn't even know about, and that might have happened long before you were born.

Courts are interpreting pollution legislation of the mid-1980's so strictly a bank can be forced to pay to clean up property whose development it financed. Because major cleanups may cost much more than the value of the polluted land, and because innocent lenders are being taken to the cleaners, credit for certain small businesses and farms is becoming very hard to come by.[7]

## A Problem for Lenders and Borrowers

Mr. Chairman, you have heard from the banking industry about our increasing reluctance to lend to segments of the small business community. I documented those concerns when I appeared before the House Small Business Committee in August of 1989. Just last month, a community banker from Dana, Indiana (population 800) told the same committee:

> With the recent surge of court decisions on environmental liability, our bank has had to carefully consider what types of businesses in Dana could present liability problems. Some of the businesses that are located in Dana that could be affected by possible environmental problems are the community's only auto body shop and convenience store which is also the only place where you can buy gas in Dana. (The other service station closed because of environmental problems and cannot be reopened because it cannot get financing.) Mr. Chairman, there are only two auto repair places in the community and our bank does business with both. There is also only one fuel dealer in the community and we have loaned on the property

[7] Tampa, Florida Tribune (June 14, 1990).

where the bulk storage is done: financed and secured by that property.[8]

A representative from the National Federation of Independent Businesses (NFIB) pointed out that "although the language of the LaFalce bill specifically addresses lender liability, there is a direct connection between banks and small business. Not to overstate the obvious, but <u>small businesses unable to obtain loans are usually unable to grow</u>. It is really that simple."[9]

NFIB pointed out that there is a large segment of the business community that is potentially vulnerable to lender reluctance to loan money. This segment includes gas station owners, autobody shops, and garages. Other firms which use chemicals like printers, dry cleaners, carpet cleaners, pest control firms, or agri-business operations may also be at risk. The witness went on to add: "Later sale of their land by these business owners listed above may be stifled by reluctant banks not willing to lend to later purchasers."[10]

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[8]Statement of Lee Schroeder, President, First National Bank, Dana, Indiana, Before the House Small Business Committee (June 7, 1990).

[9]Statement of John Motley, Vice President of Federal Governmental Relations (NFIB) (June 7, 1990).

[10]*Id*.

Therefore, Mr. Chairman, the effect of overreaching judicial interpretation of Superfund on small business cannot be overstated.

## A Problem for Fiduciaries

Another major concern of bankers for environmental liability is in the trust area.[11] ABA strongly believes

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[11]For example, a recent letter to ABA pointed out:

> We were the trustee of a funded grantor trust of a certain individual who appreciated and felt a need for our investment and recordkeeping services. He happened to own, with his wife, and operate a local landfill. He became embroiled in a dispute with the state Environmental Protection Agency, which claimed that the landfill was improperly operated. Suit was filed against the owners and several other defendants in an action seeking more than $4 million in damages.
>
> We were aware of the existence of a will executed by this gentleman with standard pour-over provisions which would have transferred title to the landfill to his inter vivos trust.
>
> As you might imagine, this situation caused us to examine our position carefully, and we determined that it would be critical to the shareholders of our bank that we prevent title to the property from passing to the bank as trustee. We approached the grantor, explaining the situation and the implications of the law and its effect on the liability of the parties. We expressed our desire to resign as trustee.
>
> This placed him and his family in an awkward position. Anyone accepting the role as successor trustee was inviting, at a minimum, substantial involvement in litigation, and at worst, exposure of his or her entire net worth to liability.
>
> The matter was resolved by having this gentleman name

(Footnote Continued)

that banks should not be burdened with the liability for cleanup of hazardous substances on land merely because they hold title in a fiduciary capacity. Consider the following:

A bank may be executor (and perhaps testamentary trustee) of a decedent's estate. Included among the assets is a piece of real estate that, years before, may have been the site of a landfill or a mine, long since shut down. It is later discovered that chemical pollutants remain on the property.

The bank did not cause the pollution. Perhaps even the decedent had no involvement -- the polluter could have been a prior owner. Nevertheless, the bank, as current owner, could be liable for the total cleanup even beyond the assets of the estate or trust.

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(Footnote Continued)
his spouse as trustee. Approximately two weeks after having made the change, he died. His wife is now immersed in the litigation. As co-owner of the property, she was exposed anyway. But she now bears the entire burden of litigation as well as the other duties befalling her as trustee. She has not participated in the business, has no financial background, and, in essence, has been thrust into the very type of situation that her husband originally hoped to spare her by naming an independent corporate trustee.

One need only change the circumstances of this case slightly to find an almost impossible situation. If both husband and wife were killed and wanted to leave their assets in trust of the benefit of their heirs, query who would be willing to serve as trustee.

Liability can result in a number of other ways. For example, in older cities, prior uses of property such as dry cleaning, jewelry making, or a whole host of other uses, unknown to even current residents, could have led to ground pollution. Should a bank unwittingly take such property into trust or an estate, liability for cleanup costs could result.

Bank fiduciaries may become involved with contaminated real property in any number of ways. In executorships, the bank's activities may range from a limited involvement requiring only maintenance of the property until a suitable buyer can be found. A bank may also be a testamentary trustee which will require active management of the property for the benefit of the beneficiaries, for example, the decedent's minor children. A bank may also assume legal title when the trust holds obligations secured by real property and foreclosure on the obligation is required. Finally, in the event of a default on a bond issue, a bank as an indentured trustee might be required to take legal title or be required to manage certain real property for the benefit of bondholders. Not to do so may render a bank liable to the bondholders.

Unfortunately, CERCLA provides little protection for bank fiduciaries trying to avoid liability. The so-called "third-party" defense requires that the contamination be due

solely to actions of a third party with whom the bank has no direct or indirect contractual relationship. 42 U.S.C. 9607(b)(3). Because a contractual relationship would include trust agreements, a bank would not come within the meaning of the statutory defense, but for a provision know as the "innocent landowner" defense.

That defense applies if the real property was acquired after the disposal of the hazardous substance and, 1) at the time of acquisition, the defendant did not know and had no reason to know any hazardous substance was disposed on or at the property or 2) the defendant acquired the property through inheritance or bequest. 42 U.S.C. 9601(35)(A). Even where a bank fiduciary meets the stringent requirements for the innocent landowner defense, it may still be subject to liability under CERCLA. Because bank fiduciaries may be required to maintain the property, albeit for a short period of time, for the benefit of the beneficiaries until such time as the property is sold, they risk being held liable as operators rather than owners of the contaminated property.

Nor does abandonment represent a viable option. If a trustee chooses to abandon the claim of a trust, the beneficiaries may allege a breach of fiduciary duties.

This same dilemma holds true for indentured trustees that normally have no liability for the underlying business.

If there is an event of default, however, and the trustee, pursuant to its obligation under the trust indenture, acquires title to, or has to actively manage the business or the contaminated property, the indentured trustee may well be deemed an owner or operator for purposes of CERCLA. Again, abandonment of the property is not an option as the indentured trustee will have certain obligations to the bondholders under the terms of the indenture.

As a result of CERCLA's strict liability provisions and in an effort to protect themselves from such liability, bank fiduciaries have become reluctant to accept appointments for certain trusts designated as high risk. Prior to accepting an appointment, a bank will follow procedures similar to those for commercial lending activities. For example, a bank will physically inspect the property to be held in trust as well as all potential acquisitions that may occur as a result of secured obligations held by the trust. Inspections will cover not only the property itself but also facilities in the general vicinity of the property. Research of the history of the property -- both its former owners and tenants and former uses -- will be required. Soil samples and groundwater tests will also be taken. Environmental audits ranging in cost from $1,500 to $20,000 may also be necessary.

A bank fiduciary will also inquire whether any business to be held in trust is incorporated. If it is not incorporated and is, in fact, a proprietorship or a partnership the fiduciary might immediately become liable upon acceptance of the account. It would be very difficult to successfully argue that the fiduciary is not the owner or operator if the interest it took upon acceptance of the account was that of proprietor or general partner. On the other hand, the fiduciary may not be able to avoid liability even if the business is incorporated since courts will pierce the corporate veil in order to recover environmental cleanup costs. See United States v. Northeastern Pharmaceutical and Chemical Co., 810 F.2d 726 (8th Cir. 1986), cert. denied, 108 S. Ct. 107 (1987).

Mr. Chairman, the net effect of these pre-acquisition screening procedures is to increase costs and delay the appointment of a trustee and any distributions to the beneficiaries. Moreover, unless a fiduciary is satisfied of the risks associated with the real property to be held in trust, no professional fiduciary will accept appointment. This situation is not uncommon where the property previously housed a gas station or other potentially hazardous business. In such a situation, the trust or estate is left without the benefit of a professional fiduciary's guidance.

<u>Courts Have Misinterpreted Superfund</u>

The ABA believes that Senator Garn's proposal would not fundamentally change CERCLA, but rather restore its original intent. The Association believes that it was the intent of the Congress to exclude innocent lenders from liability, but that court interpretations have totally undercut that intent.

Most of the litigation involving commercial lenders under CERCLA focuses on two aspects of the lender's relationship with the borrower. Such suits attempt to show that the lender is an owner or operator of the property where the cleanup costs have been incurred. The typical fact pattern involves a lender which finances a business borrower and takes a security interest in real property. (A "business borrower" can include an agricultural borrower. While CERCLA contains an exception to liability for damages resulting from the application of a federally registered pesticide product, 42 U.S.C. § 9607(i), there are other situations in the agricultural lending context which can result in CERCLA liability.)

CERCLA defines "owner or operator" in § 9601(20)(A). Although this definition is somewhat circular, it specifically states that the term does not include a person "who, without participating in the management of a vessel or facility, <u>holds</u> indicia of ownership primarily to protect

his security interest in the vessel or facility." (Emphasis supplied.) This definition, in effect, exempts a mortgagee from CERCLA because the mortgagee would fall outside the four categories of "responsible parties."

Cases such as U.S. v. Maryland Bank & Trust Company, 632 F. Supp. 573 (D. Md. 1986); U.S. v. Mirabile, No. 84-2280 (E.D. Pa. Sept. 4, 1985), 15 Envtl. L. Rep. 20,994; and Guidice v. BFG Electroplating and Manufacturing Co. Inc., 732 F. Supp. 556 (W.D. Pa. 1989) consider the scope of the exemption for holders of a security interest in real property. Both the Maryland Bank and Trust and Guidice decisions construe the language of § 9601(20)(A) narrowly and conclude that a mortgagee loses its exemption from CERCLA liability when it forecloses on the property. These courts base their decisions on the fact that the lender no longer "holds" (present tense) indicia of ownership to protect its security interest but, upon foreclosure, actually becomes the owner of the property. The Mirabile court did not take such a strict interpretive approach. It ruled that the bank's foreclosure and other activities in the subsequent four months prior to selling the property were "undertaken merely to protect [the bank's] security interest in the property" and did not cause the bank to lose its statutory exemption under CERCLA. Mirabile, 15 Envtl. L. Rep. at 20,996.

Mirabile and Guidice also consider another important aspect of the exclusion from the definition of owner or operator -- the degree of control the lender may exercise over the borrower's business and still remain outside of CERCLA. This is a key issue for lenders because liability under the Act can occur even though there has been no foreclosure. (In fact, liability can arise even though the lender has not taken a mortgage on the real property.) It is not unusual for a commercial lender, especially one whose borrower is having financial difficulties, to become involved in some aspects of the borrower's business in order to preserve the lender's financial stake in repayment of the loan. As the cases point out, the primary focus in this area is on the degree of the lender's participation in the management of the borrower.

However, a recent court decision has modified the analysis of "owner" liability found in these earlier cases and greatly exacerbated the problem. United States v. Fleet Factors Corp., No. 89-8094, slip op. (11th Cir. May 23, 1990).

As the Dallas Times Herald stated in an editorial on June 9:

> On May 23, a federal appellate court... ruled a bank, which had foreclosed on the property of a bankrupt firm and auctioned it off several months later, was liable for cleaning up the property though it had had no role

> in managing the company. The court held that secured creditors should be liable if they 'could effect hazardous waste disposal decisions,' whether or not they actually exercise a role in management or know anything about hazardous waste disposal.
>
> If these decisions stand, banks that routinely lend operating or expansion funds to small businesses, such as local gas stations, or large industries will have to close their lending windows to avoid liability for problems they had no hand in.[12]

We believe that this Court of Appeals has now established a new and broader standard of lender liability than previously existed. This case holds that, despite the explicit exclusion in the Superfund law for lenders who hold a security interest in property, it may be <u>inferred</u> from the nature of their financial relationship with their borrowers that such lenders are owners or operators of property and thus liable for cleanup.

<u>Fleet Factors</u> focused on the capacity of a lender to affect financial management, as contrasted with operational management. Prior to <u>Fleet Factors</u>, the courts had found secured creditors liable for Superfund costs only where the creditor actually owned or operated the contaminated facility. Creditors became owners only after foreclosure on the property. What has confounded the business community was Judge Kravitch's sweeping language in <u>Fleet Factors</u> that:

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[12] <u>Dallas Times Herald</u>, June 9, 1990 A-20.

> [A] secured creditor may incur liability [as an "owner"], without being an operator, by participating in the financial management of a facility to a degree indicating a capacity to influence the corporation's treatment of hazardous waste. It is not necessary for the secured creditor actually to involve oneself in the day-to-day operations of the facility in order to be liable -- although such conduct will certainly lead to a loss of the protection of the statutory exemption. Nor is it necessary for the secured creditor to participate in management decisions relating to hazardous waste. Rather a secured creditor will be liable if its involvement with the management of the facility is sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it so chose. (Emphasis supplied.)

Mr. Chairman, the impact of Fleet Factors on the lending community is painfully obvious. The 11th Circuit is sending the message that prudent lenders should not continue their time-honored efforts of being active in assisting a borrower during a troubled period because if they do they are liable for any pollution cleanup costs. Lenders will now be safer taking a complete hands-off approach to their loans and ignoring their security interest in the facility or real estate that serves as collateral. This decision opens lenders to environmental liability for participating in financial aspects of the borrower's business that were not considered a basis for liability under Mirabile, Guidice, and the lower court decision in Fleet Factors. (See, 724 F. Supp. 955 (S.D. Ga. 1988).)

Rather than setting forth a bright-line test to guide lenders, the panel creates an amorphous standard which makes it even more difficult to determine what a lender can safely

do. It may not be too farfetched to say that anything more than lending money and requesting that the borrower pay it back with interest would trigger liability under the panel's test. Of course, this means that lenders will be even more reluctant to lend at all to certain types of businesses.

The decision in Fleet Factors holds that a lender with the "capacity to influence" a borrower's hazardous waste management decisions becomes liable for cleanup costs and other damages under CERCLA. The catastrophic nature of such damages calls into question the continued value of what are now deemed to be prudent lending practices. The overly-broad nature of the panel's decision is unnecessary to resolve the issues which were presented to the court and threatens to cause great harm to both lenders and borrowers.

## Lender Defenses

In addition to the exemption in the definition of owner or operator discussed above, CERCLA establishes several defenses to liability. These are found in § 9607(b) and relieve a person from liability under the Act where the damages from a release or threatened release of a hazardous substance are caused solely by an act of God, an act of war, or "an act or omission of a third party...." (Emphasis supplied.) From the perspective of the commercial lender the so-called third party defense is the most important

because in the typical case where the lender acquires real property by foreclosure, it will have been the borrower or some other third party who has actually caused the release of the hazardous substance.

There are several qualifications to the third party defense. The "third party" must be someone other than "an employee or agent of the defendant" or someone whose act or omission occurs in connection with a contractual relationship. § 97607(b)(3). Since enactment of the Superfund Amendments and Reauthorization Act of 1986, P.L. 99-499, it is clear that the term "contractual relationship" includes "land contracts, deeds or other instruments transferring title or possession..." § 9601 (35)(A). Despite this language, a defendant who acquires contaminated real property may still be entitled to assert the third party defense if it, he or she can show that the property was acquired <u>after</u> the hazardous substance was placed there and that "[a]t the time the defendant acquired the facility the defendant did not know and had no reason to know that any hazardous substance which is the subject of the release... was disposed of on, in, or at the facility." § 9601(35)(A)(i).

The limited scope of these defenses is readily apparent. In particular, the third party/innocent landowner defense provides little in the way of true protection. The

litigation expenses necessary to establish the defense when coupled with the cost of environmental audits make this defense an extremely, expensive and uncertain way of avoiding liability. In addition, there are no guidelines establishing what is an appropriate level of inquiry and even if there were, nothing prevents the EPA from pursuing a lender to recover cleanup expenses if hazardous substances are discovered. In any event, this defense is not available in the situation found in Fleet Factors where the lender is charged with operating or managing the borrower.

## Nature of Liability

Liability under CERCLA is far-reaching. Frequently, a lender that forecloses and buys a mortgaged property or takes back a deed in lieu of foreclosure may find itself liable to the federal government for cleanup costs that may well exceed the value of the real estate and improvements. Banks may also be directly liable under Superfund for cleanup costs that can easily exceed the loan amount. A 1988 report indicated that estimates "show the number of potential cleanup sites around the country as over 20,000 and the total cleanup costs as over $300 billion."[13]

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13 Angelo and Eggert, "Environmental Considerations in Business Transactions." Paper presented to the American Bar Association, Section of Business Law, Banking Law Committee, October, 1988.

Another major problem with CERCLA is that it imposes liability retroactively. Thus, a defendant can be held liable under CERCLA for the cleanup from activities that occurred 60 years ago, even though CERCLA was not enacted until December 11, 1980. Experts have opined that "there is no reason to believe that the parties who now engage in the generation, treatment or disposal of hazardous materials or the cleanup of hazardous waste sites, will not be held liable for damages caused by these activities years in the future."[14] Therefore, there is no assurance of protection for lenders who have competently handled their responsibilities under CERCLA today.

CERCLA has also been interpreted to impose joint and several liability on everyone involved with a contaminated site, including a lender. When the harm cannot be divided and apportioned appropriately, all liability can be imposed upon any one defendant, or upon all of them. It then becomes attractive for the Environmental Protection Agency (EPA) to focus its enforcement efforts on only those parties involved with a site that are financially well-off, whether they are directly responsible for the damage or not. Financial institutions are often perceived as being the logical choice for footing the cleanup costs because of the

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[14] Id.

"deep pocket" syndrome. As a result, financially viable entities, or those that are generally believed to be viable (including banks), might end up paying for cleanup costs that others have caused, years ago.

Many courts have also ruled that CERCLA imposes personal liability. A corporate officer's or shareholder's personal assets can be subject to CERCLA liability. The corporate form may sometimes provide no protection against liability for certain individuals because a court may choose to rule that the shareholder or officer is an "operator" under CERCLA, and thus, directly and personally liable.

Finally, liability under CERCLA is strict as well as joint and several. The strict liability standard (or liability without consideration of fault) has been imposed by the courts. The third-party or "innocent landowner" defense is so limited in fact that it provides minimal protection for lenders. Any direct or indirect contractual relationship between a defendant and a responsible party will invalidate the defense and expose the defendant to liability.

## Other Laws Imposing Liability

While this testimony focuses primarily on the lender problems associated with court interpretations of

CERCLA, there are several other risks to lenders beyond Superfund.

The federal Superfund statute is not the only source of potential liability for the borrower and lender. Some states, including Massachusetts, New Hampshire and New Jersey, have also enacted "Super Lien" provisions which permit the state to clean up properties where toxic wastes are found and to collect the costs from the owner, operator, or some other responsible party. If the cleanup costs are not paid, they become a lien against the property that has a super priority over all other liens, security interests, and mortgages. A lender in one of these states may find its lien subordinated to the extent of the cleanup costs, which frequently greatly exceed the value of the property and the bank's loan on it. These statutes dramatically affect a secured lender's recourse to ensure payment of a loan. Thus, the banking industry is faced with the expense of becoming expert in federal and state environmental law and auditing of property. Some states have enacted "mini-Superfund" laws prohibiting the discharge of hazardous substances and authorizing state environmental agencies to clean up discharges and to recover the costs from responsible parties. These state statutes often raise many of the same problems for lenders as CERCLA.

The Federal Resource Conservation and Recovery Act (RCRA) 42 U.S.C. § 6901 et. seq., requires the EPA to establish a comprehensive, "cradle-to-grave" hazardous waste management program.

Title 42 U.S.C. § 6991 regulates the majority of underground storage tanks. The regulations interpreting RCRA require owners of underground storage tanks (USTs) to register information about the tanks with state regulators and the regulations include a comprehensive regulatory scheme for financial responsibility and external release detection systems. Most older USTs have a life of 15 to 20 years. Some sources estimate that as many as 50 percent of current USTs leak. UST cleanups generally involve groundwater contamination and can be more costly than a cleanup involving soil contamination. Leaking underground storage tanks are a major risk for lenders who extend credit without verifying the condition of USTs and the borrower's compliance with environmental laws. While lenders have focused primarily on their liability under CERCLA, any solution should address the potential liability of innocent lenders under RCRA.

## Economic Impact

The effect of the confusing liability on borrowers has been well documented. As the Chairman of the House Small Business Committee, John LaFalce, stated:

> "The real loser here is the small business community... well-run, credit worthy businesses that cannot obtain the financing they need to survive because their lenders are afraid of Superfund liability."[15]

What must also be emphasized is the plethora of industries that are affected by lender reluctance to provide financing. Many sites do not fit the scenario of rusting barrels oozing with noxious substances. The following is a <u>partial</u> list of potential problem businesses:

* Residential areas and developments -- may contain asbestos fill (a hazardous substance) or be located over former landfills;
* gas stations and other businesses with underground storage tanks, such as auto dealerships and fleet operators;
* auto repair shops;

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[15]Opening Statement of Rep. John J. LaFalce, Chairman, Committee on Small Business, June 7, 1990.

* dry cleaners;
* tool and die shops;
* wood preserving facilities;
* scrap yards;
* railroad facilities;
* utilities;
* bottling and canning facilities;
* metal fabricating facilities;
* semiconductor plants;
* chemical manufacturers and distributors;
* fertilizer or pesticide producers and distributors.

The American Bankers Association also recognizes the exposure faced by the agricultural community in the environmental area. A recent ABA publication, "Agricultural Lenders Guide to Environmental Liability," stated in the introduction:

> In recent years, we have seen the problems of environmental contamination transfer from the owner of a property to the lender who financed the property. While the charge-offs due to this transfer are still not commonplace in agricultural banks, they are increasing at an alarming rate. In addition, rural residents and consumers are focusing more and more attention on carryover and residues from the use of chemicals in agricultural enterprises.[16]

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[16] "Agricultural Lenders Guide to Environmental Liability," 1990, American Bankers Association.

The businesses affected in the agricultural community are extensive. Businesses such as feedlot operations, grain elevators, co-ops, fertilizer and chemical dealers and suppliers, poultry operations, meat packing and rendering facilities, cattle ranches, hog production facilities and traditional crop operations may generate, use or dispose of hazardous materials or generate other wastes which pose a risk to the environment.

Since lenders often make loans secured by residential properties, any of those properties located near landfills or other environmentally hazardous areas will also be a cause of great concern to the financial industry.

## Proposed Legislative Solution

Mr. Chairman, I would like now to turn to Senator Garn's bill, S. 2827, which provides in section 1102 that depository institutions, other mortgage lenders, and the federal banking agencies (including the Farm Credit Administration) shall have only limited liability under statutes that impose "strict" liability for environmental releases.

The banking industry is pleased that Senator Garn is addressing what has become a difficult and expensive problem for both lenders and borrowers.

S. 2827 is a straightfoward approach to the confusion and hardship which both lenders and borrowers are suffering under present law.

Subtitle B (Limitation on Liability for Nonculpable Activities) would exempt from liability insured depository institutions or mortgage lenders for the "release, threatened release, storage or disposal of hazardous or potentially dangerous substances from property that was acquired through foreclosure, held in a fiduciary capacity (such as in a trustee situation) or held, controlled or managed pursuant to the terms of an extension of credit."

The exemption would not be available to anyone who caused the release of the hazardous material or actually knew about a hazardous substance on a piece of controlled property and failed to take all reasonable actions necessary to prevent the release of the material. Finally, under the bill, the exemption would not be available to anyone who benefited from the removal <u>but only to the extent of the actual benefit</u>.

The bill also requires the banking agencies to assure that depository institutions develop adequate procedures to evaluate potential environmental risks that emanate from the property.

This last provision is important because there is presently an effort underway to develop voluntary standards for environmental due diligence in commercial real estate transactions. This process is being conducted under the auspices of the American Society of Testing and Materials. Groups such as the American Bankers Association, American Bar Association, Fannie Mae, Mortgage Bankers Association, National Association of Home Builders, and the National Association of Realtors are participating in this effort in the hopes that such standards will bring efficiency to this area and ensure that the level of inquiry required is practical and reasonable.

## Response to Criticism of Limiting Lenders' Environmental Liability

Mr. Chairman, I would like at this point to address some of the concerns that have been raised about the various legislative proposals designed to deal with the growing problem of environmental liability. Quite frankly, the ABA believes that these concerns are either invalid or vastly overblown. Therefore, let me deal with them one at a time.

The first concern that is raised relates to the potential for an increased cost to Superfund. As I understand it, the concern is that if the lending institutions do not pay for the cleanup, a larger burden

will be imposed on the Superfund itself. The first point that should be raised with respect to this concern is a question of fairness. If, in fact, the lender has nothing to do with causing the pollution, it does not seem fair that the government should impose a burden on the lander merely because it is a convenient "deep pocket" and this does not appear to have been Congress' intent.[17] It is only appropriate that there should first be some culpability on the part of the lender. Otherwise, the same argument could be made about any source of funding -- to cite an extreme example, the first three people to walk down the street past the relevant waste site -- if they do not pay for it, the government will have to pay more.

In addition, it must be emphasized that in the long run the government is not likely to obtain a significant amount of funds from the lending community. Any funds that are obtained will be obtained somewhat in the fashion of a lottery. Lenders are quickly learning that in order to protect themselves, they must not foreclose on property that may have an environmental problem. After Fleet Factors,

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[17] See, e.g. Interpreting the Meaning of Lender Management Participation Under Section 101(20)(A) of CERCLA, 98 Yale Law Journal 925 at 928 (1989) which points out that:

> [a] policy of imposing liability on banks because they are "deep pockets" is not supported by the statute, which explicitly exempts secured creditors from liability under certain conditions.

lenders will, unfortunately, also start making adjustments in the way they deal with their borrowers before foreclosure -- for example, not seeking to provide financial advice to troubled borrowers who may have pollution problems. Therefore, in the long run, the only lenders who will be caught are those who make mistakes in handling distressed borrowers or those who become involved with property where the pollution was hidden. Most significantly, lenders will have no choice but to stop lending to those types of businesses which present environmental risks.

Nevertheless, there is no doubt that innocent lenders will, under current legal interpretations, provide some additional funding for pollution cleanup that will not therefore be required to come from Superfund; however, the trade-off for this use of the innocent lenders' deep pockets is tremendous economic dislocation. Again, whole categories of businesses, agriculture, and, potentially, consumers will find it extremely expensive if not impossible to obtain financing. It is clear that the cost of the economic dislocation which will be caused greatly outweighs any benefit from additional funding that may be obtained from lenders' pockets.

The second concern that is sometimes raised is that if legislation, such as Senator Garn's proposal, is enacted, lenders will no longer have the incentive to perform

environmental audits. While it is not clear to the ABA why lenders should be required to be "detectives" assigned to ferret out environmental problems, the truth is that the lenders will have a tremendous incentive, even after the passage of legislation along the line of Senator Garn's bill, to continue, and even expand, the practice of performing environmental audits on properties on which they are lending. The reason for this is quite simple: if the property is polluted, the lender stands to lose the entire value of its loan. This alone provides tremendous motivation to assess the condition of the collateral. Not only is the security value of a given property impaired by pollution, but the borrower is given an incentive to walk away from the loan, knowing that the property is impaired or even worthless. Furthermore, since the borrower will be liable for cleanup costs, the ability of that borrower to repay the loan from other sources will be impaired or wiped out.

Therefore, I can assure the Committee that lenders will continue to perform environmental audits and, rightly or wrongly, serve the "detective" role. In fact, numerous programs are underway throughout the lending industry to develop new and innovative responses to the need for environmental audits.

As I mentioned earlier, the ABA is a participant in a 300-member coalition of interested parties that is developing voluntary standards on environmental assessments in commercial real estate transactions. Our objectives are: (1) to ensure the efficiency and integrity of commercial real estate transactions; (2) to facilitate compliance with applicable governmental requirements for environmental protections; (3) to improve the quality of environmental assessments; (4) to clarify the legal responsibilities associated with commercial real estate transactions; and (5) to ensure that the standard of inquiry is practical and reasonable.

The ABA is also analyzing the potential for an environmental information system to alert lenders as to the present and previous uses of particular sites.

A final concern that has been raised is that the lenders may obtain a windfall profit in a case where the lender forecloses on property which is then cleaned up by the EPA. It is our reading of Senator Garn's bill that such a windfall profit would be prohibited, and it is not the intention of the ABA to seek the capability to receive such windfall profits. The lending institution will continue to have the risk that its property will be of less value or worthless. The cleanup work paid out of the Superfund will not, in any way, benefit the lending institution.

## Impact on Federal Agencies

It is important that the Committee consider the effect that the current interpretation of CERCLA will have on the federal government.

The Small Business Administration said before the Senate Small Business Committee:

> SBA is currently faced with potential cleanup liability once it buys in collateral at a foreclosure sale upon default of an SBA borrower. When SBA honors a guaranty the collateral for the loan is assigned by the lender to SBA and within the Agency or the lender, acting at the request of the Agency, proceeds to liquidate the collateral. When SBA liquidates a direct loan it proceeds on its own with respect to its collateral. Often it is deemed appropriate by SBA to buy in the collateral at foreclosure, in order to hold the property in a custodial manner for future resale, in order to minimize the government's loss on the default.
>
> Under Federal environmental statutes, it is possible that such buy-ins make SBA the owner of the subject property and, as a result, potentially liable for cleanup costs. Even though SBA is a lender of last resort, thereby incurring more risks than private lenders, we do attempt to minimize the government's losses upon a borrower's default. If the Agency is found to be a party responsible for cleanup costs, that only adds to Federal liabilities.
>
> SBA now faces the possibility of spending unknown amounts of money for site cleanups simply because of foreclosure actions taken to minimize the government's loss following the default of a small business borrower.[18]

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[18] Statement of Sally B. Narey, General Counsel, U.S. Small Business Administration, Before the Committee on Small Business, U.S. Senate, March 21, 1990.

The present law is also having a negative impact on the ability of the RTC to sell assets.[19] This impact is only going to increase as concern about lender liability grows and grows, as it certainly will. There are two ways that the current situation will cost the RTC money -- and we suspect the cost may eventually be in the billions of dollars. First, potential purchasers of RTC property are going to pay less, since they must be concerned about their potential liability on RTC property. But the impact of the current interpretations goes beyond that. In order for a purchaser to buy property from the RTC, he or she is probably going to need a loan. It is going to be very difficult, if not impossible, in many cases where pollution may be present for the potential purchasers to obtain financing. This difficulty will arise because lenders will be reluctant to lend on property which may have pollution problems. This difficulty and/or added expense will be

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[19]As the Director of the FDIC's Office of Legislative Affairs wrote Ray Natter of the Senate Banking Committee Staff in a letter dated March 1, 1990:

"Absent enactment of Senator Garn's legislation, the ability of the FDIC and the RTC to resolve failed institutions expeditiously would be impaired if we must incur environmental study expenses before foreclosing upon properties which are potentially contaminated. FDIC and RTC funds are designed to protect depositors and provide stability to the nations' financial institution system and it is preferable that such funds not be diverted to unintended uses such as environmental cleanup costs."

reflected in lower prices, fewer bids, and, in some cases, no bids on RTC properties.

The second way in which the current situation will have a negative impact on RTC is that those purchasing S&Ls will be much more likely to return assets (mostly loans) to the RTC. It is widely understood that the RTC is better off the more it can move assets to the purchasers of a given S&L. However, the purchaser of an S&L -- say, for example, a bank holding company -- is going to be very reluctant to keep any assets, even if they may appear to be performing loans, unless that purchaser can be assured that there are not potential environmental liability problems with respect to such assets. To have any assurance, the purchaser would need to do extensive environmental audits, and of course, even such audits are not foolproof. The result is that such purchasers of S&Ls are much more likely to give back assets to the RTC, thus greatly increasing the expense to the RTC and, ultimately, to the taxpayers.

The letter of invitation to testify also requested that the ABA comment on the effect of lender liability on the deposit insurance funds. Obviously any situation which results in potential major liability to insured depositories can have a negative impact on the deposit insurance funds. This impact could occur in two ways. First, it is possible that, for a troubled institution, cleanup liability could

cause the institution to be placed in receivership. Second, particularly with respect to smaller banks, a single major case of lender liability could cause a particular institution, which is in a healthy condition, to exhaust its capital. This latter case is not theoretical. In recent testimony before the House Small Business Committee, a small Montana bank outlined how its potential liability could have a major negative impact on its overall capital level.

In the case of the savings and loan industry, since its insurance fund is exhausted, any increase in S&L failures caused by lender liability would result in a direct cost to the taxpayers. In the case of the Bank Insurance Fund, which does have a strong funding base, the increase in costs would be borne by the industry itself through increased insurance premiums and/or lower rebates.

## Conclusion

Mr. Chairman, I testified last year before the House Small Business Committee on the crisis in small business lending due to concern about environmental liability. Since that time, there has been a groundswell of support for restoring the Congressional intent for lender responsibility under Superfund. Business groups have joined the effort, and over 250 members of the House have cosponsored H.R. 4494. The incredible decision in Fleet Factors dramatically

raises the stakes for the U.S. economy.

CERCLA has become a trap for the lending community with widespread negative economic implications. It is not only lenders which face threats to their economic health. A wide range of businesses including service stations, dry cleaners, high-tech manufacturers, industrial concerns and agriculture are paying -- and will continue to pay -- the cost of imposing environmental liability on lenders. These "costs" are not simply the added fees necessary to conduct environmental audits of real estate or higher interest rates caused by the greater risk (or lower value of real estate as collateral) of certain types of loans, but also include the inability of borrowers to get any financing at all. If no relief is forthcoming, lenders will simply be forced to stop extending credit to those borrowers which create exposure to environmental liability either because the type of business they are involved in or because their balance sheet offers the lender little protection.

By removing the lender and fiduciary from liability (except in cases where they have caused or contributed to the release or threatened release of a hazardous substance), the liability can be placed on the party or parties actually responsible for the damage. More importantly, the negative impact on businesses, agriculture and, in some cases, individual consumers which is growing into a tremendous

economic problem, will be abated. We urge the Congress to move as expeditiously as possible to enact legislation along the lines of S. 2827.

I would be happy to answer any questions.

Senator GARN. Thank you.
Mr. Roberts.

## STATEMENT OF WILLIAM J. ROBERTS, LEGISLATIVE DIRECTOR, ENVIRONMENTAL DEFENSE FUND

Mr. ROBERTS. Thank you, Senator.

My name is William Roberts. I serve as Legislative Director for the Environmental Defense Fund. On behalf of EDF and its 150,000 members, I want to thank Chairman Riegle and Senator Garn for expressing an interest in the views of the environmental community on the important issue of lender liability for environmental risks. EDF strongly opposes S. 2827 and other legislation to alter lender liability, because of its profound impact on environmental protection and its cost to taxpayers.

Our written statement describes our views in detail. And I will use this opportunity to summarize our position.

As we celebrate the 20th anniversary of Earth Day, we can all look back on a wide range of environmental accomplishments, and a growing awareness that the economic health of this Nation depends on a clean and safe environment.

Fortunately, Congress has been foresighted enough to adopt major legislative initiatives to build an environmental ethic into the way we do business.

These developments in environmental law have had implications for many segments of our economy, including the capital markets. With increasing environmental obligations in the business community, it is more important than ever for those who finance the business community to carefully assess the environmental risks of their borrowers.

Banks, savings and loans, and other lenders provide funds to businesses in this climate. To protect the value of their loan, both for the secondary market and ultimately for the Federal taxpayer who ensures the underlying deposits, lenders should be expected to vigilantly investigate borrowers who are environmental risks. Careful lenders will adjust their interest rates, or incorporate other conditions into their loan agreements, to account for these risks.

Unfortunately, the experience with the ongoing savings and loan scandal has amply demonstrated that lenders do not always act carefully and cautiously in underwriting their loans. Indeed, many commercial loans are resold to secondary markets, so primary lending institutions may have very little incentive to guard against major liabilities affecting either the borrower or the collateral. And in the face of this weak incentive to carefully underwrite environmental risks, Congress and the regulatory agencies overseeing lenders have done little, if anything, to fill this gap with stiff underwriting requirements.

Why, then, did lenders require environmental audits in each of 300 transactions surveyed as part of a study in 1988? Why is it now common for banks to require potential borrowers to fill out questionnaires describing their potential environmental liabilities? The answer can be summed up in one word: Superfund.

Superfund gives the Federal Government two powerful tools to clean up toxic waste sites. First, it establishes a standard of liabil-

ity for those releasing toxic chemicals into the environment, which allows State and Federal enforcement officials to make those responsible pay for the cost of cleanup. Superfund liability is the weapon of choice in the Federal Government's fight against toxic waste: it makes the polluter pay.

The second tool available in the Superfund law is the fund, itself. Established with taxpayer revenues, Superfund was created to finance so-called orphan sites, sites where none of the responsible parties can be made to pay for cleanup costs. Only if those directly or indirectly responsible cannot be made to pay, will the Federal Government open up its Superfund checkbook.

Although the use of Superfund liability allows State and Federal officials to cast a wide net for potential violators, lenders have been given special protection from Superfund's broad liability.

The Superfund statute will not attach liability to a bank, savings and loan, or other lender who merely holds a collateral or other secured interest in contaminated property.

In addition, even when a lender becomes the owner of a contaminated property through foreclosure, Congress provided protection by adding a provision to the 1986 Superfund amendments which bars liability if the contamination was caused by a third party and the lender did not know, and had no reason to know, that any hazardous substance had been released at the site. This provision exempts banks, savings and loans, and other lenders from liability, as long as they exercise due diligence in making loans and evaluating potential environmental risks.

In fulfilling their due diligence obligations under Superfund, banks have required their prospective borrowers to undertake various types of audits and agree to warranties and other loan conditions to demonstrate adherence to sound environmental practices. As a result of these requirements, borrowers have had to act more responsibly to address environmental risks, both to avoid their own liability and to induce lenders to provide financing. The result has been substantial improvements in environmental protection and hopefully the avoidance of future Superfund sites.

Due diligence has also protected taxpayer dollars. As noted earlier, the taxpayer-funded Superfund is to be used as a means of last resort to clean up contaminated properties. If those responsible cannot be made to pay, the Fund is used to clean up sites. Under current law, if a bank or savings and loan fails to exercise due diligence in underwriting environmental risks, the lender is liable for cleanup costs. Without this obligation on lenders, the taxpayers would have to pay for cleanup costs through Superfund.

EDF believes that all of the gains made in environmental protection by the Federal and State Superfund laws will be dramatically weakened by S. 2827. This bill largely exempts lenders from any law imposing strict liability for the release of hazardous substances. In our view, S. 2827 undercuts the protection of current law in several important ways.

First, the bill will preempt at least 28 State statutes, listed on page 7 of our statement, that impose strict liability for environmental damage. It will also preempt other States whose common law allows actions against those responsible for the release of hazardous substances into the environment. In every major Federal

environmental law, Congress has explicitly preserved the ability of State governments to apply tougher requirements if they believe it's appropriate to do so. This flexibility and recognition of States' rights has led to innovative and valuable approaches to solve our environmental problems. Indeed, many of the provisions of the Federal environmental laws began as State statutes. We strongly oppose this unwarranted disruption of State laws.

Second, S. 2827 eliminates the due diligence obligation of lenders contained in current law. This bill would allow and encourage banks, savings and loans, and other lenders to take a see-no-evil-hear-no-evil approach to environmental risks. By its terms, the bill imposes liability only if the lender had actual knowledge of hazardous substances that could cause environmental harm. That's on page 10 of the bill. The only way for a lender to avoid this liability is actually to discontinue environmental audits and environmental questionnaires. Because, under this bill, what you don't know can't hurt you. Only if you actually learn about environmental risks, can the lender be held liable. As this committee and the Congress consider ways to improve lender practices by savings and loans and banks, we believe it's the wrong place and the wrong time to encourage lenders to turn their backs on sound underwriting.

Third, S. 2827 exempts lenders who run a borrower's day-to-day operations. Current law does not consider a lender an owner or operator of a polluting facility if its only indicia of ownership is its security interest in the property, as holder of collateral. However, if the lender is deeply involved in the day to day operations, the lender may be liable. That's as it should be. S. 2827, however, eliminates any liability for lenders no matter how involved they may become in the day to day operations of the borrower.

Lenders can and do become shadow managers of a borrower's business. As in Fleet Factors, lenders can become so deeply enmeshed in the activities of the borrower that they in effect operate the company. And, like any operator, they should be liable for contamination that occurs during their involvement.

Fourth, S. 2827 provides a safe harbor that will encourage nonlenders to escape liability. The protections of S. 2827 extend to mortgage lenders and insured depository institutions. However, because the definitions of "mortgage lender" and "insured depository institution" are so loosely defined, many firms will create ownership schemes to take advantage of S. 2827's limitation on liability. One example will illustrate the problem.

Suppose a large electronics firm with potential Superfund liability purchases or establishes an affiliate credit company which makes home equity loans. The entire electronics firm could then be transferred to a trust in which both the beneficiary and the trustee are the credit company. In this scheme, the Federal Government could not recover the cleanup costs because the credit company qualifies as "mortgage lender" under S. 2827 and no liability is imposed as long as the contaminated property is held in a fiduciary capacity which includes a trustee. Because the credit company did not cause the pollution after establishing the trust, the electronics firm and the credit company can escape liability.

We assume S. 2827 was not intended to allow these outcomes. However, by creating a safe harbor from Superfund liability, pol-

luting firms will have a compelling incentive to find ways to structure ownership arrangements to avoid liability. In our view, it is probably impossible to fully anticipate all the ways liability could be avoided. We oppose S. 2827 because it reaches well beyond lender liability and could actually exempt nonlender businesses from liability as well.

Finally and perhaps most importantly, S. 2827 will leave the cost of cleanup on the backs of State and Federal taxpayers. If S. 2827 were the law today, a lender would not be liable for cleanup costs, even if it was involved in the day to day management of its borrower's polluting business. Instead, the taxpayers who finance State and Federal Superfund programs would be left with the tab. There is simply no reason to use the scarce resources in State and Federal Superfunds, which are designed to be used only as a last resort, to bail out banks and savings and loans, whose management activities or underwriting practices could have prevented the contamination in the first place. It's unfair to the taxpayers and it's damaging to the environment.

Congress has been wary of lenders who have dumped poor business decisions in the laps of Federal taxpayers. We would urge Congress not to make the same mistake twice.

S. 2827 also addresses liability concerns of the Resolution Trust Corporation, FDIC, and other governmental entities. EDF believes that preserving Superfund liability for lenders will actually help the FDIC and RTC by encouraging lenders to make responsible underwriting decisions. We also believe that any fears of liability by the agencies, themselves, are more than adequately addressed in current law.

Under current Superfund law, the only actions required of the RTC, FDIC, or other agencies who involuntary acquire contaminated property is that they exercise due care after they acquire the property and take precautions against foreseeable acts by others who may contaminate the property in the future. These minimal obligations are not only environmentally prudent, they provide some assurance that the Federal Government will be able to preserve the value of its holdings until they are sold, minimizing losses to taxpayers. Given the protection afforded governmental agencies under current law, it's no surprise that EPA has never named the RTC or FDIC as a potential responsible party in any Superfund issue. Indeed, it's difficult to imagine a scenario in which these agencies could be liable under Superfund, unless they acted imprudently with respect to property they currently own or operate.

In conclusion, the Environmental Defense Fund is strongly opposed to S. 2827. We believe that Superfund liability has not only enhanced environmental protection but has encouraged lending institutions to carefully underwrite environmental risks. This encouragement has helped protect depositors, and consequently, the Federal Deposit Insurance Funds. Enacting S. 2827 would completely undermine the gains made by Superfund. Lenders would be encour-

aged to ignore environmental risk. Depositors funds would be unnecessarily jeopardized, a majority of States will have their Superfund statutes preempted, and taxpayers will be more likely to foot the bill for costly Superfund cleanups.

For all these reasons, we urge the committee to oppose S. 2827.

[The complete prepared statement of William J. Roberts follows:]

**STATEMENT OF WILLIAM J. ROBERTS**
**LEGISLATIVE DIRECTOR**
**ENVIRONMENTAL DEFENSE FUND**

***before the***

**COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS**
**UNITED STATES SENATE**

*July 19, 1990*

My name is William J. Roberts and I serve as Legislative Director for the Environmental Defense Fund. EDF is composed of attorneys, scientists, and economists committed to seeking practical solutions to environmental problems. On behalf of EDF and its 150,000 members, I want to thank Chairman Riegle and Senator Garn for expressing an interest in the views of the environmental community on the important issue of lender liability for environmental risks. S. 2827 and other legislation to alter lender liability could have profound implications for the environment. We hope this Committee will weigh these implications carefully as it considers this legislation.

This statement reviews the increasingly important role of environmental issues in the capital markets, the scope of liability for lenders under federal and state Superfund laws, and the impact S. 2827 will have on environmental protection. At the request of the Committee, our statement also reviews the impact of Superfund on federal deposit insurance funds.



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## THE CAPITAL MARKETS AND ENVIRONMENTAL RISKS

As we celebrate the 20th Anniversary of Earth Day, we can all look back on a wide range of environmental accomplishments and a growing awareness that the economic health of this nation depends on a clean and safe environment. We no longer allow the degradation of our environment to achieve short term goals. We have learned that pursuing economic growth without regard for the environment can result in the kind of industrial blight we see in East Germany and other parts of Eastern Europe.

Fortunately, Congress has been foresighted enough to adopt major legislative initiatives to build an *environmental ethic* into the way we do business. As a result, we have witnessed significant improvements in our environment. The Clean Water Act, the Clean Air Act, the Resource Conservation and Recovery Act, and the federal Superfund law are only a few examples of the steps Congress has taken to strike a balance between economic growth and preservation of our natural environment.

These developments in environmental law have had implications for many segments of our economy, including the capital markets. With increasing environmental obligations on the business community, it is more important than ever for those who finance the business community to carefully assess the environmental risks of their borrowers.

*Investors and Environmental Risks.* In today's market, those who acquire or merge with other companies routinely require an extensive environmental audit prior to purchase to assess possible environmental liabilities. Deals can be made or broken depending on the outcome of such an audit. Investors are also concerned with the potential impact of environmental liabilities on the stocks and bonds they own in publicly traded firms. For this reason, businesses are required by the Securities and Exchange Commission to publicly disclose their liabilities to allow investors to determine whether such liabilities will hamper the value of the company's stocks or bonds.

*Lenders and Environmental Risks.* Banks, savings and loans and other lenders provide funds to businesses in this same climate. To protect the value of their loan, both for the secondary market and, ultimately, for the federal taxpayer who insures the underlying deposits, lenders should be expected to vigilantly investigate borrowers for environmental risks. A business facing Superfund liability, for example, may be a poor risk to a lender, depending on the impact such liability could have on the business' ability to repay the loan. Careful lenders will adjust their interest rates or incorporate other conditions into their loan agreement to account for these risks. In addition, lenders should have a strong interest in guarding against the diminution in value of the collateral underlying their loan. Environmental audits and warranties applicable to the collateral may be needed to protect the security interest underlying the loan.

Unfortunately, the experience of the ongoing savings and loan scandal has amply demonstrated that lenders do not always act carefully and cautiously in underwriting their loans. Indeed, because many commercial loans are resold in secondary markets, the primary lending institution may have very little incentive to guard against future environmental liabilities affecting either the borrower or the collateral. And, in the face of this weak incentive to carefully underwrite environmental risks, Congress and the regulatory agencies overseeing lenders have done little, if anything, to fill this gap with stiff underwriting requirements.

SUPERFUND AND LENDER LIABILITY

Why, then, did lenders require environmental audits in each of 300 transactions surveyed as part of a study in 1988? Why is it now common for banks to require potential borrowers to fill out extensive questionnaires describing their potential environmental liabilities. The answer can be summed up in one word: **Superfund.**

*How Superfund Works.* Superfund gives the federal government two powerful tools to cleanup toxic waste sites. First, it establishes a standard of liability for those releasing toxic chemicals into the environment which allows state and federal enforcement officials to make those responsible pay for the cost of cleanup. The standard of liability is strict, joint and several -- which means that an individual or business can be liable without regard to fault and that the government can collect the

cleanup costs of commingled contamination from any one defendant. The defendants in a Superfund case are free to seek contribution from each other for the costs of cleanup and the court may divide up the costs equitably, but the burden of assigning blame is on the defendants, not the federal government. Thus, Superfund liability is the weapon of choice in the federal government's fight against toxic waste -- it makes the polluter pay.

The second tool available in the Superfund law is the fund itself. Established with taxpayer revenues, the Superfund was created to finance so-called *orphan* sites -- sites where none of the responsible parties can be made to pay for cleanup costs. The fund was and is the means of last resort to pay for cleanup costs. Only if those directly or indirectly responsible cannot be made to pay will the federal government open its Superfund checkbook.

*Superfund Liability and Lenders.* Although the use of Superfund liability allows state and federal officials to cast a wide net for potentially responsible parties, lenders have been given special protection from Superfund's broad liability. Past and current owners and operators of contaminated property can be liable, as can transporters of hazardous substances, and those who by contract or other means arrange for the transport of hazardous substances to the contaminated site.

But, the Superfund statute will not attach liability to a bank, savings and loan, or other lender "who, without participating in the management of a . . . facility, holds indicia of ownership primarily to protect his security interest in the . . . facility" is not liable. 42 U.S.C. 9601(20)(A). This means that merely holding a collateral or other security interest in contaminated property is not enough to trigger Superfund liability.

In addition, even when a lender becomes the owner of contaminated property through foreclosure, Congress provided protection to lenders by adding a provision to the 1986 Superfund amendments which bars liability if the contamination was caused by a third party and, at the time a lender acquired contaminated property, it "did not know and had no reason to know that any hazardous substance which is the subject of the release or threatened release was disposed of on, in, or at the facility." 42 U.S.C. 9601(35)(A)(i). This provision exempts banks, savings and loans and other lenders from liability as long as they exercise "due diligence" in making loans and evaluating potential environmental risks.

In fulfilling their "due diligence" obligation under Superfund, banks have required their prospective borrowers to undertake various types of audits and agree to warranties and other loan conditions to demonstrate adherence to sound environmental practices. As a result of these requirements by lenders, borrowers have had to act more responsibly to address environmental risks, both to avoid their own liability and to induce

lenders to provide financing. The result has been substantial improvements in environmental protection and, hopefully, the avoidance of future Superfund sites.

"Due diligence" has also protected taxpayer dollars. As noted earlier, the taxpayer fund established by Superfund is to be used as a means of last resort to cleanup contaminated properties. If those responsible cannot be made to pay, the fund is used to cleanup sites. Under current law, if a bank or savings and loan fails to exercise due diligence in underwriting environmental risks, the lender is liable for cleanup costs. Without this obligation on lenders, the taxpayers would have to pay for cleanup costs through the Superfund. For all these reasons, the Environmental Defense Fund strongly supports the provision of the current Superfund law imposing commonsense obligations on lenders to evaluate environmental risks.

STATE LAW AND LENDER LIABILITY

Many states have followed the lead of the federal government by establishing numerous state "Superfund" programs. In fact, according to an EPA study released last September, a majority of states have adopted statutes that impose strict liability on those responsible for toxic contamination. They include:

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|---|---|---|---|---|
| *Alaska* | *Indiana* | *Missouri* | *Pennsylvania* | *Vermont* |
| *Arizona* | *Iowa* | *Montana* | *Rhode Island* | *Washington* |
| *California* | *Louisiana* | *Nebraska* | *South Carolina* | *Wisconsin* |
| *Connecticut* | *Maine* | *New Hampshire* | *South Dakota* | |
| *Florida* | *Maryland* | *New Jersey* | *Tennessee* | |
| *Hawaii* | *Massachusetts* | *Ohio* | *Texas* | |
| *Illinois* | *Minnesota* | *Oregon* | *Utah* | |

In addition, numerous states impose liability on polluters through common law tort actions. The combination of state statutes and common law gives states additional tools to compel polluters, including irresponsible lenders, to clean up toxic waste sites. The combination of state and federal requirements on lenders has provided strong and positive incentives on lenders and borrowers to manage environmental risks.

S. 2827 WILL DRASTICALLY WEAKEN ENVIRONMENTAL PROTECTION

All of the gains made in environmental protection by the federal and state Superfund laws will be dramatically weakened by S. 2827. S. 2827 largely exempts lenders from "any law imposing strict liability for the release . . . of hazardous . . . substances from property (1) acquired through foreclosure; (2) held in a fiduciary capacity; or (3) held, controlled or managed pursuant to the terms of an extension of credit." In our view, S. 2827 undercuts the protection of current law in several important ways.

*S. 2827 Preempts State Law.* The bill will preempt at least 28 state statutes that impose strict liability for environmental damage. It will also preempt other states whose common law permits actions against those responsible for the release of hazardous substances into the environment. In every major federal environment law, Congress has explicitly preserved the ability of state governments to apply tougher

requirements, if they believe it is appropriate to do so. This flexibility and recognition of states rights has led to innovative and valuable approaches to solve our environmental problems. Indeed, many provisions in the federal environment laws began as state statutes. We strongly oppose this unwarranted disruption of state laws.

*S. 2827 Encourages Lenders to Ignore Environmental Risks.* S. 2827 eliminates the "due diligence" obligation of lenders contained in current law. If S. 2827 were enacted, it would actually discourage lenders from making a careful assessment of environmental risks. S. 2827 would allow and encourage banks, savings and loans, and other lenders to take a "see no evil, hear no evil" approach to environmental risks.

By its terms, S. 2827 imposes liability only if the lender had *actual* knowledge of hazardous substances that could cause environmental harm. Section 35(c)(2). The only meaningful way for a lender to avoid this liability is actually to discontinue environmental audits and environmental questionnaires, because under S. 2827 what you don't know can't hurt you. Only if you actually learn about environmental risks can a lender be held liable. As this Committee and the Congress consider ways to improve lending practices by savings and loans and banks, we believe it is the wrong place and the wrong time to encourage lenders to ignore sound underwriting.

Lenders have argued that they are "not in the hazardous waste business" and should not, therefore, be obligated to investigate the environmental risks of their

borrowers. This argument makes no sense. In order to secure a mortgage for a house one must obtain homeowners insurance, even though the mortgage company is "not in the fire prevention or flood protection" business. In many cases, one must also obtain a termite inspection, even though lenders are "not in the pest control business."

Environmental auditing and risk underwriting makes sense not because banks and savings and loans are in the hazardous waste business, but because they are in the business of lending money. In order to lend money responsibly, they must obtain valuable collateral, ensure that that collateral will retain its value during the life of the loan, and ensure that the borrower will be able to repay the loan. Lending money is the reason lenders should be involved in assessing environmental risks.

S. 2827 contains a provision directing the federal banking agencies and the Department of Housing and Urban to develop unenforceable "procedures" to evaluate potential environmental risks. This provision is a weak and ineffective substitute for Superfund liability for several reasons. First and foremost, it is unenforceable. It carries no penalities, either criminal or civil. After just passing a tough crime bill to punish savings and loan operators for mismanagement, it would be ironic indeed if the Senate requires new underwriting criteria which carries no penalty at all. In addition, because lenders may face Superfund liability under S. 2827 for having *actual* knowledge of environmental risks, unenforceable "guidelines" to investigate those risks will almost assuredly be ignored.

Second, the procedures are to be developed by the banking agencies and HUD -- agencies with absolutely no expertise in environmental risks. If any agency should be responsible for establishing criteria for environmental underwriting it should be EPA.

Finally, we believe this section is a solution in search of a problem. Superfund works extremely well at encouraging sound environmental risk underwriting. We see no reason to add several new volumes to the Code of Federal Regulations to solve an imaginary problem.

*S. 2827 Exempts Lenders Who Run a Borrower's Day-to-Day Operations.* Current law does not consider a lender an owner or operator of a polluting facility if its only "indicia" of ownership is its security interest in the property. However, if the lender is a participant in the management activities of the borrower, the lender may be liable. S. 2827 eliminates any liability for lenders no matter how involved they may become in the day-to-day operations of a borrower.

Lenders have asserted that S. 2827 is necessary because the courts have improperly interpreted the degree of participation required to trigger Superfund liability. Lenders often cite the Eleventh Circuit Court of Appeals decision in *United States v. Fleet Factors Corp.* to prove their point. We believe the lenders' concern is unfounded

and that, even accepting the lenders' arguments at face value, S. 2827 provides far more protection than necessary to solve the alleged concerns.

The facts in the *Fleet Factors* describe almost perfectly the rationale for subjecting lenders to liability when they become deeply involved in the operations of their borrowers. The question before the court was whether the government had alleged sufficient facts to go to trial on the issue of the lender's liability for participating in the management of the borrower with contaminated property. The government alleged that the lender approved all goods shipments, established prices for excess inventories, dictated when and to whom finished goods should be shipped, determined when employees should be laid off, and controlled access to the facility and equipment of the borrower. If these allegations were true, it makes perfect sense to hold the lender liable because, in effect, the lender is operating the borrower's business and should be accountable for environmental damage caused during its involvement.

The district court in *Fleet Factors* said the government had alleged sufficient facts to warrant a trial and the appellate court agreed with that determination. That, and that alone, is the holding in *Fleet Factors*. As far as we know, the lenders have not quarreled with this holding. In our view, it would be difficult to defend an exemption from liability for a lender so intimately involved in the operations of its borrower.

Instead, the lenders have focused on nonbinding dictum in the appellate court's decision which says that a lender could be liable "if its involvement with the management of the facility is sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it so chose." Although this standard is not binding, EDF believes that it makes sense and is consistent with the Superfund statute. As the holding in *Fleet Factors* illustrates, lenders can become deeply involved in the day-to-day management activities of their borrowers. The standard set by the appellate simply says that if a lender is sufficiently involved to alter waste disposal practices, it should be liable.

In our view, lenders have raised a legitimate concern about the uncertainty associated with the scope of permissible management activities. The Eleventh Circuit and other courts are still determining the meaning of "participating in management." However, EDF believes that greater certainty can be achieved administratively, not legislatively. We believe it is appropriate and would encourage this Committee to direct the Environmental Protection Agency to prepare guidance on the permissible scope of management activities for lenders under Superfund. Given the substantial deference courts give to EPA's interpretation of federal environmental statutes, we believe the courts will adhere to such guidance.

Whatever legitimate concerns lenders may have with the permissible scope of management activities under Superfund, the provisions in S. 2827 would insulate lenders

from liability *even if they are involved in the day-to-day operations of the borrower.* Lenders can and do become shadow managers of their borrowers' businesses. As in *Fleet Factors*, lenders can become so deeply enmeshed in the activities of the borrower that they, in effect, operate the company. And, like any operator, they should be liable for contamination that occurs during their involvement.

S. 2827 contains a provision that would hold lenders liable if they caused the release or threatened release of hazardous substances. But, this provision requires the government to establish whether the borrower or the involved lender is the cause of any contamination. Borrowers will allege that the lender is responsible and lenders will allege that the borrower caused the release. Congress imposed joint and several liability specifically to avoid placing the government in the role of assigning responsibility for contamination. S. 2827 would reestablish these roadblocks.

*S. 2827's Safe Harbor Will Encourage Non-Lenders to Escape Liability.* The protections of S. 2827 extend to mortgage lenders and insured depository institutions. However, because the definitions of "mortgage lender" and "insured depository institution" are so loosely defined, many firms will create ownership schemes to take advantage of S. 2827's limitation on liability. Two examples will illustrate the problem.

Suppose a large electronics firm with potential Superfund liability purchases or establishes an affiliate credit company which makes home equity loans. The entire

electronics firm could then be transferred to a trust, in which both the beneficiary and trustee are the credit company. In this scheme the federal government could not recover cleanup costs from contamination because the credit company qualifies as "mortgage lender" under S. 2827 and no liability is imposed as long as the contaminated property is "held in a fiduciary capacity," which includes a "trustee." Because the credit company did not directly "cause" any contamination after establishing the trust, the electronics firm and the credit company can escape liability.

In addition, a bank could purchase a hazardous waste transportation company which hauls waste from generators to dumpsites. Suppose one of the dumpsites is placed on the Superfund list and the owner's property is foreclosed by a second lender. The bank's hazardous waste transportation company could escape the liability net by claiming it is a leasing company (leasing transportation services) affiliated with an insured depository institution and that the contaminated property was acquired through foreclosure.

We assume S. 2827 was not intended to allow these outcomes. However, by creating a "safe harbor" from Superfund liability as broad as the exemption contained in S. 2827, polluting firms will have a compelling incentive to find ways to structure ownership arrangements to avoid liability. In our view, it is probably impossible to fully anticipate all the ways liability could be avoided. We oppose S. 2827 because it reaches

beyond lender liability and could actually exempt non-lender businesses from liability as well.

*S. 2827 Will Leave the Cost of Cleanup On the Taxpayers.* Finally, and perhaps most importantly, S. 2827 will place the cost of cleanup on the backs of state and federal taxpayers. If S. 2827 were law today, the lender in *Fleet Factors* would not be liable for cleanup costs, even though it was supposedly involved in the day-to-day management of the polluting business. Instead, the taxpayers who finance state and federal Superfund programs would be left with the tab. There is simply no reason to use the scarce resources in state and federal Superfunds, which are designed to be used only as a last resort, to bail out banks and savings and loans whose management activities or underwriting practices could have prevented the contamination in the first place. It is unfair to the taxpayer and damaging to the environment.

Although S. 2827 contains a provision which holds a lender responsible for any actual benefit in appreciation it may receive as a result of a taxpayer-financed cleanup, S. 2827 still leaves the potentially millions of dollars in cleanup costs to the taxpayer. Once again, this would happen even if the lender is involved in the day-to-day operations of the borrower's business. This Committee has been wary of lenders who have dumped their poor business decisions in the lap of the federal taxpayer, we would urge Congress not to make the same mistake twice.

SUPERFUND AND THE FEDERAL DEPOSIT INSURANCE FUNDS

It is important to review the impact Superfund liability has had, not only on lenders, but on federal deposit insurance funds. We have heard concerns raised recently about the financial well-being of the FDIC, and we have read daily accounts of the problems facing the RTC. However, EDF believes that preserving Superfund liability for lenders will actually help the FDIC and RTC by encouraging lenders to make responsible underwriting decisions. We also believe that any fears of liability by the agencies themselves are more than adequately addressed in current law.

*Superfund Liability Protects Insured Deposits.* The benefits of Superfund's "due diligence" obligation reach beyond its obvious environmental benefits. This Committee is primarily concerned with the health of the nation's lending institutions and the solvency of the federal insurance funds protecting depositors. As noted earlier, without the prospect of Superfund liability, lenders have little incentive to carefully underwrite environmental risks into the loans they issue. Banks, savings and loans, and other lenders could easily shift loans secured by potentially contaminated property to secondary markets without risk of liability. Indeed, by providing explicit exemptions from liability for primary lenders, Superfund liability could attach to those in the secondary market, who have no means to assess the environmental risks of the borrower.

In addition, banks and savings and loans are using federally insured deposits to make loans. This Committee has been struggling to clean up the savings and loan scandal which was caused in large measure by lax underwriting practices and weak oversight by federal regulatory agencies. By preserving prospective Superfund liability, this Committee can be assured that banks, savings and loans and other institutions will maintain a strong self interest in properly underwriting environmental risks.

*Superfund Protects Insurance Funds as Asset Holders.* One argument for legislation amending Superfund liability is fear that the Resolution Trust Corporation or the Federal Deposit Insurance Corporation could be held liable to the extent they hold title to property as a result of the savings and loan failures. However, in our view, current law provides ample protection from liability for all government entities, including those listed in Section 35(d) of S. 2827.

Under the current Superfund law, the RTC, FDIC and other agencies are protected by provisions in Superfund which bar liability if a third party was responsible for toxic contamination. 42 U.S.C. 9607(b)(3). Although this defense is normally unavailable if the property were acquired in a land transaction, the law explicitly permits the use of this defense if "the defendant is a government entity which acquired the facility by escheat, *or through any other involuntary transfer or acquisition,* or through the exercise of eminent domain authority by purchase or condemnation." Because the RTC, FDIC, and other agencies listed in S. 2827 are "governmental entities" who acquired

property through an "involuntary transfer," they can avoid liability if a third party was responsible for the contamination.

The only actions required of the RTC, FDIC or other agencies who involuntarily acquire contaminated property is that they exercise "due care" after they acquire the property and take "precautions against forseeable acts" by others who may contaminate the property in the future. These minimal obligations are not only environmentally prudent, they provide some assurance that the federal government will be able to preserve the value of its holdings until they are sold, minimizing losses to taxpayers.

Given the protections afforded governmental agencies under current law, it is no surprise that the EPA has *never* named the RTC or FDIC as a potentially responsible party in any Superfund action. Indeed, it is difficult to imagine a scenario in which these agencies could be liable under Superfund, unless they act imprudently with respect to the property they currently own or operate.

In our view, the statutory changes proposed in S. 2827 with respect to the RTC, FDIC and other governmental entities are unnecessary and could potentially lessen environmental protection and jeopardize the value of the assets held by these agencies. Under the terms of S. 2827, governmental entities would have to possess *actual* knowledge that hazardous substances were released from the government-owned facility. This absolves the RTC, FDIC and other agencies from any responsibility to even

minimally protect its properties from third party contamination -- which could have a devastating impact on the property's value if such contamination occurs.

## CONCLUSION

In conclusion, the Environmental Defense Fund is strongly opposed to S. 2827. We believe that Superfund liability has not only enhanced environmental protection, but has encouraged lending institutions to carefully underwrite environmental risks. This encouragement has helped protect depositors and, consequently, federal deposit insurance funds.

Enacting S. 2827 would completely undermine the gains made by Superfund. Lenders would be encouraged to ignore environmental risks, depositors funds will be unnecessarily jeopardized, a majority of states will have their Superfund statutes preempted, and taxpayers will be more likely to foot the bill for costly Superfund cleanups. For all these reasons, we urge the Committee to oppose S. 2827.

Senator GARN. Thank you, Mr. Roberts.

In the 16 years, I've been on this committee, I have virtually always opposed the overriding of States' laws. Years ago, there was almost always a standard Garn amendment that if we did, there was always at least a 3-year override period for State legislatures to say, we disagree. So my record is very clear on that.

However, I don't know whether you are aware or not that 73 percent of the entire dollar volume losses occurring in the S&L crisis was State-chartered institutions? And who's paying the bill? The Federal Government.

Sixty-three percent of those losses occurred in just two States, Texas and California. I wish to God we had overridden those State laws that allowed mushroom farms and windmill farms and so on. We wouldn't be costing the taxpayers $500 billion or something like that. So I think there are times that it becomes necessary, even from my basic philosophy not to override.

I'm sure you're surprised by that because it certainly isn't reported that way; 69 percent of the repossessed properties that the FDIC and RTC have taken over are in one State, Texas. The American taxpayer is paying the bill for what those State legislatures did.

Now, I agree with much of what you've said in your testimony, interestingly enough. It makes the polluter pay. Boy, I agree with that. The polluter ought to pay. That's not what my bill is about. You talked about the exemptions in addition where the lender becomes the owner of a contaminated property through foreclosure. Congress provided protection through the 1986 Superfund amendments. I agree.

Congressman La Falce talked about the intent of Congress in 1980. That is not the way it's happening in the courts, and I don't know why the courts are making some of the decisions they are. If the language doesn't convey what my intent is, which is to put us back with the very things you've enumerated, which you think are good in the 1980 and the 1986 act, that's where I want to be; back where we were so that those exceptions are real.

And your testimony, I think, vastly exaggerates the bill. Either it does, or I don't understand my bill. Because the charges you make in vehement opposition to it I think not only are inflammatory but are simply not correct. Certainly, it's not the intent of me or my cosponsors to do that.

My first question is simply, with some of the examples that I've given, do you think it's fair. I don't even know why we're debating the environment here today. This bill, if enacted without a word changed would not change the way Congress intended CERCLA to work. I think your testimony would be a great deal more credible if you would come and say, we have some problems with this. We don't like the State override, we're worried about this, without making such exaggerated claims that simply are not going to happen. I'm not an attorney but, boy, I can drag out a lot of fine attorneys that would certainly indicate that. Because I didn't write the bill, but some attorneys did. So environment isn't the issue.

We're trying, when you talk about this being put back on the taxpayers, that's one of the reasons I'm here, not to put the costs back on the taxpayers. We've got enough banks and enough sav-

ings and loans that have been taken over, without adding more to them. Again, I make the comment, if we need more money for Superfund for orphan sites, if we could get the people who caused the problem, I'm the first one who wants to get them, civil and punitive damages, rather than falling back on the taxpayer. Those who pollute ought to pay. Boy, your statement is absolutely correct. But the nonpolluters shouldn't have to pay. And if we've got these orphan sites, if we can't pin something down and find somebody that's responsible, then let's put more money in Superfund. I'll vote for that.

But, really, it's not personal with you, but I don't understand that your environmental concerns override any element of fairness, because I'm not arguing with you on cleanup of Superfund, not at all. I don't have a problem with what you're trying to accomplish or what you want to accomplish. But I have an incredible problem of putting blame and big monetary damages and costs on institutions that are innocent. It just doesn't make any sense to me.

Can you answer that for me, in a very general sense, how can you, as a taxpayer, paying for part of the S&L crisis, want to put a burden on innocent financial institutions or the FDIC, that had nothing to do with the pollution?

Mr. ROBERTS. The answer is that I don't. And I think the proper way to look at this is to see, if under current law, an innocent S&L or an innocent bank or the RTC or the FDIC can be made liable. And I think the answer is, no.

I think, if you examine the statute, and I think with, frankly, the help of EPA providing, as it has suggested to this committee, greater guidance on what the terms mean, and given the courts' great deference to EPA in its interpretation of the statute, that any uncertainties which may have compelled the initiation of this type of legislation, could easily and administratively be solved.

I don't think that the intent of the language or the spirit of Superfund puts innocent banks, innocent S&L's, or the RTC at risk.

Senator GARN. But it has. Did you hear my first example? Do you think that's fair for a bank that financed a brand new building on an unpolluted site some 15 years ago, had nothing to do with the management whatsoever, wasn't involved, they simply foreclosed because the dealership went bankrupt, they are now stuck with the building, nobody will buy it until it's cleaned up and the cleanup costs are several times the value of the building. So it isn't a matter of what you think; it's a matter of what I know from specific cases that are taking place. There's no way that a bank should be responsible in that particular case. If they participated, if they knew about it, they should not be exempt. However, the exceptions that you enumerate and I agree with, are simply not working. That's what I'm trying to accomplish.

If you've got some language that will accomplish that, put us back to the intent of Congress. I don't care about my bill. Give us some positive, constructive help in how we make sure innocent people are not going to be caused to pay large sums of money.

Mr. ROBERTS. I think the response is, once again, under Superfund law, a banker or lender is responsible for failing to exercise due diligence in making a loan. Right now, there are two independent groups that are developing standards with EPA's supervision to

develop the guidelines. What is due diligence, what does it mean for a bank or S&L to undertake due diligence in compliance with current law.

The second way Superfund liability can attach to a bank or S&L is if it becomes so involved in the management activities of the business that they are, in effect, operating the business.

Senator GARN. I don't disagree with that.

Mr. ROBERTS. In those circumstances, they should be held liable. EPA has suggested today, in its statement, that it intends to develop guidelines for what it means to become actively involved in the program and management of a business. I think it's appropriate for the committee to wait for EPA and the rest of the administration to discuss the means by which those guidelines can be developed in a coherent way.

I'm not disagreeing with you. In fact, our statement is explicitly sympathetic to the notion that banks and S&L's face some uncertainty about when their management activities of a borrower's business become so sufficient as to warrant and trigger Superfund liability. Also in our statement, we make clear that we think this can be solved administratively, and should be given a chance to be solved administratively, as EPA has suggested here today.

Senator GARN. What I would hope you would do, then, is make some constructive suggestions for how this might be accomplished, rather than exaggerating greatly—much of your testimony, in fact most of it, I don't have any problem with but I do think there are some vastly exaggerated statements in your testimony, compared to what the written language in my bill will do.

My time is up.

Senator Graham.

Senator GRAHAM. Thank you, Senator.

I'm going to focus my questions on a false statement of this legislation. And that is, as if the legislation only applied to Superfund law. I'm doing that because I think there are a whole set of other questions about the application of this law to in fact the full reach of other Federal and State environmental laws.

But assuming, for this series of questions, that we're only talking about Superfund, I'd like, first, Mr. Roberts, I see this in two chronological periods. The first would be the period in which the depository institution is in the position of a lender with a secured creditor. The second phase is when they foreclose on the property of that formerly secured creditor. And now they are in the position of holding title.

In the first instance, as a secured creditor, you seem to outline a series of steps that you felt a lender ought to take, prior to making a mortgage loan, in order to have exercised sufficient environmental due diligence. My feeling is that you are suggesting an imposition of obligations on a lender that would in fact be very chilling in terms of a lender's willingness to go forward. The secured creditor exemption says that the lender can proceed ahead and be free of obligation if the lender can demonstrate that he has not participated in the management of the vessel or facility and holds the title primarily to protect a security interest.

Why do you think we should go further in terms of obligations on the secured creditor?

Mr. ROBERTS. I think once again it is important to tease apart the two obligations on the lender. What you are describing actually blends them together. We do believe in fact that Superfund law has created a wonderfully positive incentive for the environment for lenders to carefully evaluate their borrowers before a loan is made to minimize environmental risks that that borrower—that they, the bank, may face from the borrower's own practices.

We think that as the environmental laws have changed and toughened that the obligations on the businesses involved, the borrowers, have also increased. Frankly, in our perspective I think, after the testimony of the American Bankers Association, it makes sense and it should be encouraged to have banks carefully examine their borrowers and the risks they incur from lending money.

The second form of liability is the one that you just read, which is presumably coming close to the end or to the beginning of the foreclosure process. Many lenders become very actively involved in the management activities of a business. Probably the most publicly known of that might be Donald Trump. I think that to the extent that lenders become so enmeshed——

Senator GRAHAM. Are you suggesting that he owns a hazardous waste site, along with all the other things?

Mr. ROBERTS. I do not know where he stores the gasoline for the Trump Shuttle, but it is possible. The short answer is that when a business, a bank, or an S&L becomes so deeply involved and enmeshed in the activities of its borrower that it could have affected the outcome of the hazardous contamination problem, it too should be liable.

I think many people have cited Fleet Factors. I think it is worth looking at the facts alleged by the Government.

First, the lender hired and fired the borrower's personnel. It decided who and when to ship goods to the borrower's customers and was in all other ways basically running that company. If that is the case and contamination occurs, that lender should be liable.

I think that what is important, and what EPA has suggested doing and what we have recommended that they do, is to set forth clear guidelines on circumstances in which a lender would trigger Superfund liability because of their management involvement in the activities of a property.

Senator GRAHAM. Mr. Mitschow, on that issue of the degree of management involvement by a secured creditor, Mr. Roberts has in his prepared statement on page 12 listed the areas of control which Fleet Factors exercised over its debtor. Using those as a specific example, do you think they represent a sufficient amount of management involvement by a secured creditor to result in the secured creditor being held responsible for the activities of its debtor?

Mr. MITSCHOW. I do not know the particulars of that aspect of Fleet Factors. What the industry is focusing on is really the interpretation the court gave in its statement that extended the responsibility to banks. What we have to do—because what we are dealing with here are not major corporations but rather small businesses where we have to look toward collateral as our source of repayment—if judicial decisions are coming out that say that we can be held liable for problems that are pre-existing, then we are going to preclude that collateral from our evaluation.

So whether or not the Fleet Factors' degree of control removed them from a certain defense of the law I do not think is what the industry has been focusing on, but rather the result of that extended judicial opinion on just how responsible the banking industry is for the underlying problems.

There is no question, though, that if an institution is responsible and does manage the facility, does cause pollution, they should be responsible for the cleanup. We are not trying to evade that at all. So assuming whatever the facts are in that case, they stand on their own. But I really feel that there is a chill going through the industry that is unwilling to take collateral from small businesses, and they need to use that to avail themselves of financing instead of compromising in this fashion.

Senator GRAHAM. It seems to me that in terms of that first phase, the secured creditor exemption, what is the status that could cause the secured creditor to be held liable for the activities of its debtor? What constitutes participating in the management of the vessel or the facility? That is an area that could be dealt with either administratively or congressionally by some greater definition of what constitutes "management" for the purposes of that secured creditor exemption. That is to say, it does not take the full extent of this proposed law change in order to deal with that specific issue.

Mr. MITSCHOW. If that specific issue were in isolation, I would certainly agree. The problem is that we do have what someone referred to before as a Catch-22 situation. To the degree that we involve ourselves in making sure we do not have a hazardous waste situation, we lose our innocence. It is hard to protect against both situations simultaneously.

Senator GRAHAM. If I could, Senator, move on to the second phase which is after the secured credit has now come into title through foreclosure serving in a fiduciary capacity or control pursuant to an extension of credit, it seems to me the basic difference between the current innocent landowner defense and the language of the proposed legislation, S. 2827, is that in the landowner defense provision the landowner has to take affirmative action. We have to undertake at the time of acquisition an appropriate inquiry to determine what the situation was, and if that inquiry indicates there is a problem, you have to take customary practices in order to minimize liability.

The legislation focuses on the avoidance of affirmative action. We cannot cause the release. You cannot have actual knowledge that there was a hazardous substance or you cannot benefit, but it does not put you on any status of obligation to take affirmative action to find out. Is that the essential difference?

Mr. ROBERTS. Senator, it actually does a little bit more than that. I am not sure, once again, since this is a discussion piece, whether or not it was intended, but the second exemption actually requires the lender to have actual knowledge of the presence of hazardous substances. I think what that does is affirmatively encourage lenders, as I pointed out in our statement, to ignore risks.

I think this is a case where, if that was not intended, Senator Garn did not mean that banks actually be encouraged not to pursue at least some diligence in investigating their borrowers, and

we return to a due diligence standard, we are back in current law because that is what current law requires.

I think the other important difference is that, with respect to causing contamination, right now one of the reasons that Congress developed the standard it did of Superfund liability was to take the issue of causation off the back of Government who was bringing these cases and put it on the parties, so that when they sue each other for contribution, as Mr. Strock pointed out they are free to do, they can use the court's equitable powers to decide who should pay what.

But putting the burden, as this bill would, on the Government to establish causation would almost assuredly mean that liability will not be attached to a bank or an S&L. So I think the difference is more than just shifting the focus. It actually has affirmatively worsening effects on the environment.

Senator GRAHAM. Mr. Mitschow, what is your sense of the difference between the provisions that are necessary to gain the benefit of the innocent landowner defense, as opposed to the provisions that are in the legislation?

Mr. MITSCHOW. If the law were interpreted as we believe it was meant to be as written, and these defense that have been alluded to would stand up in court, I do not think there would be a need for this legislation at this time. It is really the fact that the courts have extended the liability of the lending institutions beyond the original exemptions and negated these defenses, at least in our mind.

We are dealing with very small margins on these small business loans. We are talking about the fact that the cost of defending ourselves by using these exemptions that have already been challenged successfully in court makes it prohibitive to approve them and continue to take these sorts of risks. The loser is going to be the small business borrower.

Senator GRAHAM. Senator, my final question is: Assuming that the consequence of passage of this law and the use of the exemption exclusion provision, as opposed to the continuation of current law, results in a difference in the ultimate results—i.e., an institution, a mortgage lender, a depositor of the institution—that would have been denied the innocent landowner defense and thereby held liable, is now thereby precluded from liability because of this change in the law, what would be the consequence of that?

Let us take a hypothetical situation, to use the one that Senator Garn has suggested. We have an automobile that had been in the showroom. It has some hazardous materials. It is going to cost $500,000 to clean up the hazardous materials. When we passed this law, the institution which has taken possession of the showroom is exempt from liability. Who pays?

Mr. ROBERTS. We do. The taxpayers would. To the extent that there is contamination of the site in that example, and presumably it was the lender who foreclosed on that auto dealer—you cannot sue the auto dealer because he does not have any money—the lender would not be liable in that circumstance even if the lender, like the lender in Fleet Factors, was actively running the operation.

Senator GARN. Let me say that I totally disagree with that characterization. That is not my intent, and I do not believe the law would exempt somebody who was involved in the management, as you say. In my example, it was not involved at all in this particular case. So that is not my intent.

Mr. ROBERTS. I am sorry. I am sort of wrestling with the two scenarios here, but I think that in an example in which a lender was able to escape liability and, if properly involved, was foreclosed on in a bankrupt business, it would be left to a State fund, or possibly the Federal Superfund, to pay for the cost of cleanup. There is nobody else to pay for it.

Senator GRAHAM. Mr. Mitschow, what result do you think would apply?

Mr. MITSCHOW. I do not think the bank would be considered liable on the basis that they were the owner once they had foreclosed on that property. That has been the interpretation of virtually all of the banks that have looked into this situation, and the basis on which new banking policies are being established across the country, that once we foreclose on a property that has hazardous waste, we will indeed be responsible for those cleanup costs and be held to be an owner-operator. Fleet Factors just extends that one more step and says that even if you did not foreclose, you may have had control through your financial dealings. But I do not see it.

I do not see that the law has been interpreted in a fashion that allows us to be exempt from that cost.

Senator GRAHAM. I was trying to determine—I think you have correctly stated what the current law is. My question was, assuming that we passed Senator Garn's legislation and you were able to utilize the exemption provision and, since you did not cause or have actual knowledge or benefit, you were not subject to any of the exclusions, so the law applied and you were exempt from strict liability, what do you think would happen with the $500,000 in assets?

Mr. MITSCHOW. It would be exactly as previously stated. It would be cleaned up by the Superfund because that would be the source that was there to take care of the situation where there was no responsible party with the means to correct it, since the bank was an innocent lien-holder and was not construed to be the owner-operator. Then the Superfund would come into play, as I think the law was originally designed.

Senator GRAHAM. That is all.

Senator GARN. You know, the thing that is puzzling to me about these hearings is, according to the testimony received, there is nobody who has testified they want to get innocent people. So we are agreed on that.

We all agree that current law is fine. You said that in your statement. It seems to me a logical conclusion then from the actual examples we are getting that you are correct in what you say about current law. We do not need a bill. We do not need my legislation, if courts were not interpreting that law differently than was the intent of Congress as stated by one of the authors of the first Superfund bill, certainly a respected environmentalist, John LaFalce.

It seems to me there ought to be some way we could fashion some legislation that tells the courts very clearly that we want the law followed. That is all I am trying to accomplish.

It seems to me, though, Mr. Roberts, that you may be confusing two types of "due diligence." Under my legislation, "due diligence" at the time of making the loan is required by S. 2827. But current interpretations also require due diligence before foreclosure to take advantage of the innocent landowner defense.

I am not saying that "due diligence" should not be done before someone makes a loan. If they do not do their job before they make the loan, that is their problem. But if you get back into that situation I quoted from some law reviews, if you do your due diligence a second time before foreclosure, you are probably unable to use the innocent landowner defense. If you do not, you are unable to use it.

So we can talk all we want about the "innocent landowner" and agree that that is in the law in 1986, and that is what we want, but it is not working. It simply is not working, and it is not my intent to try to take away due diligence. You are absolutely right—not just in the environmental areas, but the banks, the savings and loans in many cases, have not always done the due diligence necessary. But my bill was not exempting them from doing that prior to making the loan.

I am trying to prevent this innocent person from being caught up in something they had nothing to do with.

Mr. Mitschow, Mr. Roberts argued in his prepared testimony that S. 2827 would actually discourage lenders from making a careful assessment of environmental risk and would allow and encourage banks, savings and loans, and other lenders to take a "see no evil, hear no evil" approach to environmental risk.

I guess I am sort of surprised by this conclusion, because the bill provides that lenders shall not be relieved of liability to the extent they have received a benefit from remedial action. Thus, if an institution lends on property that turns out to be contaminated, they will still suffer an economic loss either because their collateral is worth less because of the pollution, or because it was cleaned up and they received the benefit for which they are liable, and they cannot receive a benefit under my bill.

So I do not know where the lack of incentive is, if there is not going to be an economic benefit to them from closing their eyes. Why? Why would they do it? I would like both of you to answer.

Mr. ROBERTS. I think the short answer is, once again, reading from the bill it says that the exemption that you have provided from liability does not apply to someone—any person with actual knowledge of the presence of hazardous substances. I think that by requiring an exemption that only kicks in with actual knowledge really creates an incentive, a very compelling incentive, for a lender to take a "see no evil, hear no evil" approach.

Now the contrast you presented is the prospect of losing the value of a collateral property on the one hand versus the cost of paying for a cleanup of a Superfund site on the other hand. I think that, to the extent that we want lenders to act responsibly in both making loans and protecting the value of their collateral, we actually want them to be encouraged to investigate their borrowers for environmental risks. But because of the fear of Superfund liability,

I think any good counsel for a bank would counsel them to avoid learning anything that might trigger the actual knowledge exemption.

I am hopeful that is not what was intended.

Senator GARN. It was not only not intended, I do not think the language says that. Again, I am no attorney, but you are ignoring the other exemptions. That is only one. You are reading "with actual knowledge, or that has benefited from remedial or other responsibilities, only to the extent of the actual benefit conferred," and there are other exceptions. You are picking on one of the exceptions.

But from a practical matter, I assume you are an attorney and not a banker, but a banker would be absolutely stupid in this environment to close his eyes. With all this going on—with the examples of court suits—he ought to be removed as CEO of his bank if he is stupid enough to listen to a dumb attorney who advises him to keep his eyes and ears and mouth shut. That defies common sense with this nonattorney.

If I were running a bank in the environment that I am aware of, I would be out there picking in the ground myself with shovels before I made a loan. There is just no common sense to your argument on this point that this would encourage an attorney—an attorney like that ought to be disbarred.

Mr. MITSCHOW. I think we have to look at the type of industry that is going to rely primarily on collateral. You are talking about small businesses where the failure rate, unfortunately, is probably 40 percent over a 5-year period. In dealing with those types of risks, the absolute assurance of the collectability of these loans based on collateral values is necessary, and the ability of these borrowers to repay and cover their costs is extremely important.

If we now know that there is this cost potentially facing our borrower, we have to know how real that potential liability to a borrower is. Whether we have subsequent liability for cleanup or not, we have to know whether he is going to survive and be able to pay that loan in a very, very difficult economic environment for small businesses.

Second, if we are going to rely for the collateral on anything that can impair it, we certainly want to know about it. The idea of closing our eyes baffles me, as we would end up, in a mathematical sense, with a 50-percent loss ratio with small business lending. With a 2 or 3 point spread on cost of funds, that simply would not make much sense. We have to investigate these risks to make sure the borrower has the capacity to repay and our collateral is going to be there and be valuable.

Senator GARN. I do not know whether either one of you is aware of it, but here is the Thrift Bulletin for February 6, 1989, from OTS, "Environmental Risk and Liability." It is several pages long, so I am obviously not going to get into all of it, but let me summarize it:

If a site has the potential environmental risks, the thrift must conduct a phase I environmental audit. This would include:

An historical review of the use of the property;

An investigation of the property and neighboring properties;

An inspection of the site and all improvements;

Verifications as to whether the past or present owners created or discharged hazardous materials;

An analysis of old aerial photographs;

Interviews with neighbors to determine prior uses;

Provisional inspection of the buildings; and

A written report summarizing the findings.

If red flags are found in the phase I investigation, a more intensive phase II analysis is required involving soil and ground water sampling.

I do not know, Mr. Roberts, it seems to me that no thrift—they have got to go through that process. I do not understand your concerns, considering that we agree on what we are trying to accomplish.

My legislation does not change those requirements to do those environmental assessments. It does not even touch it. It does not even mention it.

Mr. ROBERTS. I guess my answer is that current law provides that if a lender had reason to know, or did not know, that is important both that he had reason to know, or reasonable likelihood to know, or knew, then he should be liable. That is our view.

In other words, if a lender fails to follow these guidelines, and I have them right here, too, if they fail to follow those guidelines, for whatever reason, they should be liable for cleanup. They are more responsible for that contamination.

Senator GARN. Let us get back to what period of time we are talking about. Before the loan is granted? Or before foreclosure?

We are talking about two different things. I do not disagree with you on before the loan. If they do not follow the guidelines and they had reason to know and did not do a good enough job, OK, hold them liable. I am talking about that innocent owner who ended up having to foreclose.

Mr. ROBERTS. I think the answer is that if the courts—and I would hope the committee would wait to hear from EPA—determine whether or not all the activities followed here may be additional ones and were sufficient to satisfy the requirements of the act for undertaking due diligence, then they would not be liable. That is the short answer, that under current law——

Senator GARN. That is your short answer, but that is not the answer we are getting from the courts.

That comes back to my point: You are dealing in hypothetical situations and what the law says. I have said at least three or four times that we do not need my legislation if the law that you continue to cite, that I say I agree with, and that Mr. Mitschow says he agrees with, we do not need a new law.

But you apparently like the court determinations—or at least that is what I am hearing from you.

Mr. ROBERTS. I think what has been unfortunate is that one of the reasons that we have heard for this kind of legislation from the lending community has been the court case, for example, of Fleet Factors which was decided 2 months ago.

I think it would make a lot of sense to read that opinion carefully, because in that opinion which had to do with what Senator Graham was calling the management activities of a lender during the period of a loan before foreclosure, that the activities of that

lender were so extensive that there could be really no question that that facility, that lender was operating that facility.

I think that is what is really important here, to really see what the courts have said. In that case, the holding was that there were sufficient allegations by the Government that that lender had been actively involved in the management activities of that borrower in that case to warrant possible further action in the lower courts. That is it.

I think that to the extent that the administrator has expressed a willingness to go forward with laying out specific guidelines in cooperation with the FDIC and other agencies of the Federal Government, it should at least give us some reason to await, I think, to see if some of the clarity that has been called for here today and which we actually recognized in our statement can be resolved administratively.

I think it would be prudent and useful for lenders to know precisely what their obligations are. That makes everything work a lot smoother and more efficiently.

Senator GARN. There are a lot of decisions made by this Congress to let the regulators decide things administratively. That is one of the reasons we have billions worth of taxpayers' liability out there. So I do not have the confidence you do in the regulators or administrative agencies or the courts.

That is why I think we need some legislation and why I would seek your support in solving this problem. If you are sincere in saying you do not want these innocent victims, then let us figure out how we can craft legislation and craft laws and not leave it up to the courts and to the regulators to make those determinations.

Mr. ROBERTS. The Environmental Defense Fund stands ready to work with the committee. We oppose this version of the legislation. We think it is too extreme. But to the extent further versions—and you yourself pointed out it is a discussion draft—come forward, we would be happy to look at them.

Senator GARN. I do not think the legislation is extreme. I think your analysis of the legislation and what you conclude is extreme. [Laughter.]

Senator Graham, do you have any other questions?

Senator GRAHAM. No questions.

Senator GARN. Gentlemen, again as with the first panel, this is an important subject. There are additional questions that I wish to ask, and I am sure other members of the committee will have additional questions. We will submit them to you in writing and seek your help and support.

Thank you, very much.

The committee is adjourned.

[Whereupon, at 4:30 p.m., the committee was adjourned, subject to the call of the Chair.]

[Responses to written questions and additional material supplied for the record follow:]

**FDIC**
Federal Deposit Insurance Corporation
Washington, D.C. 20429

Office of Legislative Affairs

August 31, 1990

Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for providing us with the opportunity to respond to follow-up questions to our testimony before the Committee on July 19, 1990. Enclosed are our responses.

In addition, we have provided Senators Garn, Heinz and Graham with copies of our response to their questions.

Please let us know if we can be of further assistance.

Sincerely,

Beth L. Climo

Beth L. Climo
Director

Enclosure

QUESTIONS FROM SENATOR RIEGLE

Q.1. At the hearing EPA indicated that it was willing to discuss with the FDIC and the RTC the application of the "innocent landowner" defense to the FDIC and RTC. I am very interested in the availability of this defense not only to the FDIC and RTC, when they act in a custodial capacity, but also to such entities, when they act in their corporate or non-custodial capacity.

I encourage your immediate discussion of the Federal and (to the extent helpful) State Superfund laws with the EPA. Following those discussions I would appreciate receipt of a report from the EPA as well as the FDIC and RTC. In the report I would want to be advised of any possible circumstances in which the deposit insurance funds or RTC's corporate assets may be at risk to satisfy liabilities that arise under the Federal and State Superfund laws.

A.1.

The FDIC and RTC will provide you with a report following our discussions with the EPA. As expressed in our testimony, we are very concerned about the risks posed by Federal and State Superfund laws to the deposit insurance funds and the RTC. In our report, we will address (1) the availability of the "innocent landowner" defense to the FDIC and RTC in their various capacities; and (2) the circumstances in which Superfund liabilities pose a risk to the deposit insurance funds or the RTC in its corporate capacity.

Q.2. What aggregate real estate related assets does the FDIC hold in its corporate capacity? What amount of these assets does FDIC believe pose environmental risk of loss or liability?

A.2.

Of the $13.2 billion in real estate related assets held by the FDIC as of July 19th, approximately $2.2 billion are held in its corporate capacity. One hundred forty-one of these corporate assets with an aggregate book value of $164 million have been identified at this time as potentially having hazardous substance problems. An additional 23 corporate assets valued at $53 million have been identified as having asbestos problems. Other properties may well be identified in the future as having hazardous substance problems.

In addition, the FDIC in its corporate capacity, may have hazardous substance exposure from the $5.5 billion in real estate related assets from large assisted bank transactions. At this time 50 properties with a book value of $200 million have been identified as potentially having hazardous substance problems.

Finally, the FDIC may have have additional indirect exposure from the approximately $13.8 billion in real estate related assets resulting from the FSLIC assistance agreements. Currently, eight of these assets with a book value of $3 million have been identified as potentially having hazardous substance problems.

Q.3. In light of the risks of liability or loss attributable to environmental conditions or regulation that lenders may be assuming, what level of confidence should members of the Committee and the Federal banking regulators have in the reported financial condition of lenders?

A.3.

The FDIC believes the public may continue to have general confidence in the reported financial condition of insured institutions. Regulated institutions must submit quarterly financial statements to the government that conform to generally accepted accounting principles (GAAP). GAAP requires that estimated probable losses from litigation be shown as a liability on financial statements. The vast majority of insured institutions voluntarily provide accurate financial reports and there are few banks that attempt to hide their true condition. Federal regulators conduct on-site examinations designed in part to flush out those institutions that misrepresent their financial results. At each examination, litigation is reviewed to determine if liabilities have been properly recorded. If an environmental liability had not been reported, the FDIC would require the institution to amend its financial statements. The problem today is that the nature of liability for environmental hazard may not arise or even be suspected for many years after the fact. There is a potential for significant unreported liability but there is no way to know its dimensions. That is partly why we support legislation making it clear that secured lenders and the FDIC are not liable merely by fact of being a lender or owner through foreclosure.

Q.4. Does the FDIC believe that it is appropriate to issue guidance or direction to insured depository institutions regarding the assessment of environmental risks that may arise from environmental conditions or their regulation? Is the FDIC likely to issue such guidance or direction within the next year? Why has the FDIC not issued guidance or direction previously?

A.4.

The FDIC expects to provide some written guidance to its examiners and bankers in regard to assessing environmental risks within the next year. Although we have been studying and following this matter for a very long time, we have not heretofore issued formal guidance because: (a) the interpretation and application of the laws has been evolving

faster than anyone can write; (b) the banking industry itself has done a respectable job in producing educational material for lenders; and (c) the press of other needs for agency resources. This is not to say however, that we have done nothing. Environmental risk has been the subject of major sessions at management and staff conferences and it is a subject covered in our examiner training schools on real estate lending.

Q.5. Is there any instance to date of the failure of an insured depository institution that is primarily or substantially attributable to the institution's incurring actual liability under the Federal or State Superfund laws? Please describe any such instance.

A.5.

The FDIC is not aware of any financial institution under its jurisdiction that has failed from losses caused by Superfund laws.

Q.6. What other data are available to the FDIC regarding either liability or loss that insured depository institutions may have incurred under Federal or State Superfund laws or other environmental law or due to environmental risk?

A.6.

We have not conducted a survey or polled banks we regulate concerning individual environmental liabilities. To date, we do not believe insured institutions have incurred extensive losses from environmental laws. Because of the evolving nature of court decisions however, the FDIC's focus is not on what has happened, but what could happen. Unless the law is changed to exempt insured institutions from this potential but unrealized liability, it is possible the next court ruling may have an unfavorable systemic impact on banks and savings associations.

Q.7. Does the data available to the FDIC confirm that the insured depository institutions that are most inclined to reduce their lending activity in the face of environmental risk are the community banker-type of institutions?

A.7.

The undefined nature of Superfund liability could result in a substantial contraction in the availability of loans to individual firms or even industries. A bank trade association has reported that community banks are steering clear of loans to small businesses most frequently associated with environmental pollution, such as gas stations, dry cleaners, auto repair shops, printing shops, and pest control companies. While we do not have

collaborating data that there has been a tightening of credit in these areas, we do know that community bankers are aware of the potential environmental liability and that cannot help but affect their overall risk assessment of certain categories of loan applicants. The complexity and cost of doing an adequate site assessment has to dissuade some lenders from even getting involved.

8. What discussions, if any, has the FDIC had with State regulators of insured depository institutions regarding environmental risks to lenders and the appropriate responses of lenders to such risks? What are the results of any such discussions?

A.8.

The FDIC staff have had conversations with State regulators on the subject of environmental risk. These talks have been informal and in the context of general meetings. While no formal supervisory programs have been written, these conversations have helped to raise the level of consciousness about the issue.

Q.9. Is the FDIC considering whether an alternative method of funding the clean-up of hazardous substances that does not depend upon strict liability of private parties, including both borrowers and lenders, is more likely to reduce the FDIC's insurance risk than pending proposals that affect the Superfund laws? What are FDIC's views on the ramifications to it of any changes in law that moves away from strict liability?

A.9.

The legislative initiative contained in S. 2827 is a step in the right direction toward reducing risk to the FDIC's insurance fund. Any departure from the standard of strict liability under CERCLA would, of course, be salutary. An alternative standard would, presumably, allocate blame and financial liability commensurate with responsibility for the contamination. Thus, in most situations neither lenders nor the FDIC would have exposure. However, even if such a lesser standard were to apply, ambiguity with respect to the actions a lender or the FDIC could take in order to preserve collateral -- without fear of liability -- would continue to affect adversely the manner in which each carries out its tasks, corporate or statutory.

By virtue of the exemptions contained in S. 2827 that remove the immunity provided under the bill to the FDIC and the other named entities, S. 2827 does not presently provide a clear basis of immunity from Superfund liability. Instead, it effectively moves away from strict liability to liability based upon fault for those named entities. As a result, S. 2827 may only change the nature of the litigation which will confront the FDIC -- not

curtail it. As stated in our testimony, it is our preference that legislation be enacted to clearly and fully exempt the FDIC from hazardous substance liability.

Q.10. <u>The FDIC testified [at page 2 of its prepared statement] that "the environmental laws...also pose significant risks to our goal of protecting depositors." It also testified [at page 3-4 of its statement] that "current environmencal laws may directly affect the soundness of the federal deposit insurance funds and the stability of the deposit insurance system generally."</u>

<u>What efforts does the FDIC undertake to share with the Administration and the Congress its views on current environmental laws or proposed environmental legislation that the FDIC believes may create significant risks to the FDIC?</u>

<u>Similarly, what efforts does the FDIC undertake to share with State legislatures through State banking regulators or otherwise its views on State legislation that may create such risks?</u>

A.10.

Generally, the FDIC has not reviewed or commented on state environmental legislation. The growing seriousness of the potential exposure of insured institutions probably means that we need to look at these state laws more carefully. Also, we support federal legislation that would restrict state Superfund liability for secured creditors and the FDIC.

QUESTIONS FROM SENATOR GRAHAM

Q.1. The court in the Fleet Factors case looked to lenders to play a role as "environmental police" to help ensure that toxic waste was handled properly by their borrowers. This forces the discovery of hazardous waste contamination or possible contamination to take place prior to the closing of a loan transaction.

Who will bear the cost of such a discovery?

Is the technology available to make lenders comfortable with these transactions?

How long will these new requirements delay a loan transaction?

What are the potential impacts of this delay on the borrowers?

A.1.

We anticipate that borrowers will bear the cost of environmental audits either directly or indirectly. We anticipate that the undertaking by a lender to determine if prospective collateral for a loan transaction is free of hazardous waste contamination will be costly and time-consuming. Further, lending to certain borrowers will in all likelihood suffer because of the nature of their businesses and/or their inability to fund the discovery efforts that the lender will pass on as part of the application process. We are advised, for example, that a Phase I environmental audit costs on average between $2500 and $5000 and may easily cost more. Such an audit typically involves but is not limited to, investigation of the site's history (examination of aerial photos, topographical maps, a title search) and its use (physical inspection, consultation with regulatory agencies, inquiry regarding solid waste management, examination of underground tanks and surrounding areas, and evaluation of the uses of neighboring property). The more sophisticated the audit, the more it will cost. A Phase II audit, which involves core drilling and other forms of sampling, is likely to cost $35,000 or more. A Phase I audit may take only 30 days to perform. A Phase II audit rarely takes less than a minimum of four to six months.

So far as we know, adequate technology exists to meet lenders' needs. Yet, lenders may not be able to purchase all available technology due to cost and they may not be able to afford the time delay to undertake every conceivable test. Lenders may often be forced to balance their need for an audit and the amount of money invested in a loan against the cost and time delay of undertaking sophisticated tests. Furthermore, even if the most sophisticated technology is used, there is still no guarantee that a technologically "correct" audit will always uncover all environmental problems.

The significant expense of environmental audits will inevitably be passed on to borrowers. Assuming that they are able to "foot the bill", the process of investigating collateral will complicate the loan process and extend the time needed for the underwriting process. Presumably such delays will preclude some borrowers from timely obtaining the capital necessary to accomplish personal or corporate goals. It should be borne in mind that virtually no collateral is free of suspicion: single family homes may have been built on contaminated landfills; farm land may have residues of toxic chemicals and fertilizers; the shopping center restaurant may do business on the site of a long gone gas station whose underground tank, whether or not still in place, may have caused soil and groundwater contamination.

Q.2. Clearing up hazardous waste sites is a huge task that requires both private as well as public action and funding. Many companies clean up hazardous waste contamination without public assistance when it is discovered and we certainly want to encourage them to do so.

Have financial institutions lent to companies to finance hazardous waste clean-up in the past?

What is the likely impact on this type of lending from the Fleet Factors case?

Are there other avenues for companies to get financing for hazardous waste clean-up?

A.2.

While we do not have any numbers, we are aware that insured institutions finance the removal or containment of hazardous waste. Large corporations have a variety of funding mechanisms to finance their operations including bank debt, commercial paper, public and private placements of debt and equity issues, inter-affiliate borrowings, insurance company loans, and internal cash flow. Small borrowers are more likely to be dependent on bank loans.

The Fleet Factors case is not directly involved with financing clean-up, but the potential liability that accrues to any lender that gets anywhere near environmental risk cannot but adversely impact a willingness to lend. Under the reasoning of Fleet Factors, if the terms of the financing for such a loan give rise to the inference that the lender could influence the borrower's hazardous waste clean-up, then that lender could well be found liable. As a result, the availability of private lending to finance hazardous waste clean-up could decrease. We are not aware of any special avenues for financing waste clean-up other than that available to any creditworthy borrower.

Q.3. <u>When a lien becomes troubled, most lending institutions attempt to workout the loans and increase their oversight of the borrowers business activities.</u>

<u>Given the recent changes in lender liability for hazardous waste, do you expect to see less workout activity by lending institutions?</u>

<u>Assuming the standards in Fleet Factors is upheld, what changes will need to take place in working with defaulted borrowers?</u>

A.3.

The lender would have to be extraordinarily careful not to exercise, or appear to exercise, such authority over the financial management of the defaulting borrower's business as to give rise to the inference that the lender could affect the borrower's hazardous waste management. This highlights the essential conflict between safe and sound banking principles on the one hand and environmental responsibility on the other. Prudent loan workout efforts necessitate involvement by the lender in the business of the troubled borrower to assure that a loan does not become non-performing or, if it is, to preclude its being written down or written off. <u>Fleet Factors</u> sends an ominous message to that prudent lender: if you do what the banking regulators expect of you, you may find yourself financing an environmental clean-up whose cost would dwarf the loss resulting from the write-down of that loan.

Q.4. <u>In Senator Garn's bill, he preempts state environmental laws that make lending institutions liable for hazardous waste contamination.</u>

<u>How much of a problem does state law present in this area?</u>

<u>Have any states addressed this problem and, if they have, what approach are they taking?</u>

A.4.

Many states have enacted environmental statutes and regulations that could subject lenders to liability for hazardous waste clean-up costs. Some state hazardous substance statutes are even more onerous than CERCLA. At least nine states have enacted laws to provide for "Superliens," which stand in front of all other liens, even recorded mortgages.

The Federal Superfund statute provides, at 42 U.S.C. §9614, that "[n]othing in this chapter shall be construed or interpreted as preempting any State from imposing any additional liability or requirements with respect to the release of hazardous substances within such State." This phrase is ambiguous and leaves open

the possibility that a state could extend liability to a class of persons -- such as lenders and the FDIC -- that pending proposals would exempt from Superfund liability. We fear that the ambiguity inherent in the phrase found at 42 U.S.C. §9614 -- as to which there appears to be no helpful cases or legislative history - will lead to unnecessary and costly litigation if S. 2827 does not explicitly preempt inconsistent state law.

At this time, we have only limited information regarding the manner in which the various states have dealt with lender liability. The State of Colorado, for example, has addressed this problem to a limited degree by statutorily defining the tasks necessary to perform an environmental audit or "due diligence to escape toxic tort liability.

Q.5. Does this liability have the potential for forcing other institutions into insolvency? We have seen a large increase in nonperforming loans and foreclosed real estate in financial institutions recently. Can you estimate the potential environmental liability that these increases represent?

A.5.

We have not conducted a survey to determine the total Superfund liability of the banks we regulate but we believe only a few of our institutions have incurred material liability to date from environmental laws. However, the continuous broadening of lender environmental liability by the courts could eventually lead to increasing insolvencies of insured institutions.

QUESTIONS FROM SENATOR GARN

Q.1 In the Fleet Factors case the U.S. Court of Appeals for the 11th Circuit stated that a lender can be held liable for Superfund cleanup costs solely on the basis of the lenders participation in the financial management of a company. What is the likely effect of the court's opinion on the ability of financial institutions to protect themselves against environmental liability while at the same time engaging in prudent banking practices designed to protect the value of a loan? If the impact would be to discourage certain types of lender involvement, what issues are raised from a supervisory viewpoint?

A.1.

**The Fleet Factors case significantly increased a lender's potential environmental risk. The uncertainty raised by this decision adds to the growing fear of other extraordinary interpretations of CERCLA, RCRA and parallel state laws. Banks know that liability might be asserted but they cannot forecast what actions today will cause future liability. This environmental uncertainty creates inefficiency. A lot of money might be spent on very expensive environmental audits that future case law may prove to have been unnecessary. Extensive legal fees and management time may have to be expended to defend against actions, even if the bank prevails. Banks may avoid profitable lending opportunities simply because of unresolved and uncertain environmental liability issues.**

**From a supervisory viewpoint, the most effective method for clarifying Superfund liability is to have Congress amend the law to more specifically define lender responsibility. This would stabilize the ground rules, allowing financial institutions to make sound environmental risk assessments.**

Q.2. Mr. Roberts testified that the provisions in S. 2827 directing the agencies to ensure that lenders implement environmental audit procedures are unenforceable. As I understand the Federal Deposit Insurance Act, any party or institution that violates any law, rule or regulation or written agreement, is subject to civil penalties that may go as high as $1 million per day. Further, any action that constitutes an unsafe or unsound banking practice is also subject to sanctions, even if no rule, regulation, or order is violated. Do you agree that the FDIC would have sufficient authority to enforce requirements relating to environmental due diligence as part of the underwriting process? If not, what specific recommendations do you have for changes that would assist the agency in enforcing the environmental due diligence requirements?

A.2.

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) gave the federal financial institutions regulatory agencies authority to assess civil money penalties against any insured depository institution which violates any law or regulation, or violates any order, agreement or any condition imposed by the appropriate agency. Further, we have other administrative sanctions for any action that constitutes an unsafe or unsound banking practice. While to date we have not used these authorities for matters like Superfund, we believe the law is broad enough to cover this. We feel this is sufficient authority to enforce requirements relating to environmental due diligence.

Q.3. Mr. Strock testified that under the CERCLA liability scheme, lending institutions generally are not liable parties. He noted that the "innocent landowner" defense was added during the reauthorization. In the course of the hearing, Mr. Strock, representing the Environmental Protection Agency, committed to work with the FDIC and the RTC and others to clarify the applicability of the "innocent landowner" defense to those entities.

Mr. Strock also indicated EPA's intent to issue guidelines on the definition of "participating in the management of a facility" under the secured creditor exemption definition of "owner or operator".

What guidance would the FDIC and RTC, in their various capacities, need in these two areas to avoid the potential liabilities raised in their testimony? If such guidance were given by the EPA or CERCLA, to what extent would that solve the problems discussed at the hearing? Would legislation still be needed? If so, in what areas?

A.3.

Absent passage of pending proposals to modify hazardous substance laws, we would request that the EPA, as the agency primarily entrusted with interpretation of CERCLA, make it explicitly clear that CERCLA's "security interest" exemption protects lenders and the FDIC even after foreclosure.

We would also request the EPA to provide detailed guidance as to various provisions of the "innocent landowner" defense. For example, clear, detailed guidance is required as to what constitutes "due care" and taking "precautions," as prescribed by Section 9607(b). The phrase, "did not know and had no reason to know," and the phrase, "involuntary transfer or acquisition," found in Section 9601 also require definition.

Notwithstanding the guidance that the EPA may provide, the FDIC and lenders may still be vulnerable to third party suits, absent amendment of CERCLA. For example, we referred in our testimony

to certain pending litigation that involves the FDIC in a receivership capacity. The present owners of the property filed this suit, and neither the EPA nor the environmental agency of the State of California are involved. Absent legislative change, we fear that such third party suits may continue unabated. Finally, in our view, unless the FDIC directly causes the hazardous waste contamination, the FDIC should not be subject to CERCLA liability.

## QUESTIONS FROM SENATOR HEINZ

Q.1. At the underwriting/commitment stage of the loan, do you require all commercial loans to have environmental audits? Do you request the environmental audit? What do you require in an environmental audit to make an intelligent decision? Do you ever require environmental liability insurance as a loan condition?

A.1.

The FDIC has no formal requirement that banks under our supervision must obtain environmental audits for all commercial real estate loans. However, bankers and our examiners have been made aware that an acceptable bank real estate lending policy should include standards and guidelines for when an environmental audit should be obtained as part of a loan commitment process. Not meeting this standard for an adequate loan policy would be criticized by examiners and bank management would be urged to effect correction. In analyzing any real estate loan, the examiners would include a review of the environmental audit if one had been prepared. The examiner would appropriately criticize the loan, management and/or the institution's lending policies if the condition and nature of the loan indicated that an environmental audit should have been conducted but had not been done. These general principles have been taught to examiners in our real estate lending schools and we expect to provide written guidelines for all our examiners in the near future.

The minimum standards for an acceptable environmental audit are still evolving, however some of the basic requirements include: the lending institution should hire the independent environmental auditor to preclude borrower influence on the findings; the scope of the audit, the assumptions and any limiting conditions must be fully explained in the report; documented support for all findings and conclusions should be included in the report; and, the report should describe the chain of title and prior uses of the property and the presence or absence of any environmental liens. There needs to be a complete on-site inspection of the property and a written description of its condition. The credentials and experience of the environmental auditor should be included.

The FDIC has not required environmental liability insurance as a condition for lending. This is a safeguard that we believe is most properly within management's purview.

Q.2. At the closing stage of the loan, do you use environmental covenants? Do you require separate environmental indemnities? Do you require periodic audits? At whose expense?

A.2.

Given the present state of the law, environmental covenants and the like are necessary to protect a lender in the event of the borrower's default. It should be noted, however, that environmental covenants may generally provide only marginal protection to lenders. Due to various recent court decisions, a lender may not be able to monitor the borrower's business on an active basis and may hesitate to involve itself in enforcing such environmental covenants, lest the lender risk being held liable as an "operator" of the borrower's business.

Q.3. In regard to administering the performing loan, are periodic environmental audits performed? By whom?

A.3.

Banks normally conduct audits, if needed, during the application stage before a loan is granted or when an existing loan deteriorates and the bank is restructing the credit or contemplating foreclosing on the real estate collateral. Performing loans do not require an environmental audit unless there has been a significant event that called for some action by the lender such as a borrower entering into a new activity that is environmentally sensitive. At some lending institutions, account officers are trained in environmental assessment to be able, while visiting their customer, to identify potential environment problems at an early stage.

Q.4. With respect to administering a non-performing loan, is an in-depth environmental audit performed? When?

A.4.

When administering a non-performing loan, the FDIC undertakes environmental audits as deemed appropriate in the circumstances, including the nature of the asset and the borrower's business operation. An environmental audit would typically be performed after efforts to work out the loan with the borrower have failed and at the time that we are considering foreclosure on the property which collateralizes the loan.

It should be noted that performance of an environmental audit may delay foreclosure and present its own complications. Following unsuccessful efforts to work out a loan, the borrower, who is still the owner of the property, may not be cooperative in permitting us access to the property. In some cases, we may be forced to obtain a court order simply to gain access. As is required to raise the innocent landowner defense, an environmental audit must be performed immediately prior to foreclosure. Obtaining an environmental audit may also create delays in obtaining title to property and selling it. A Phase I audit will delay foreclosure for at least 30 days. If the more complex Phase II audit is required, foreclosure will be delayed an additional four to six months.

Q.5. <u>During foreclosure and liquidation, do you normally remove collateral from the site? Is it sold? What steps are taken to secure collateral?</u>

A.5.

In order to recover its interest in defaulted loans and to carry out its statutory and fiduciary responsibilities with respect to receiverships, the FDIC will generally sell collateral securing defaulted loans. However, if it is learned that the collateral is contaminated with hazardous substances <u>and</u> it is estimated that the cost of clean-up and risk of liability are greater than anticipated profits from the sale of the subject collateral, then we will not be able to foreclose upon the collateral. If the cost to clean up contaminated property and the probability of liability related to the contamination are low in relation to the value of the property, then we will foreclose and clean up the property to sell it or negotiate with the buyer of our property so that the buyer cleans it up.

Whether collateral is removed from the site depends on many circumstances, including whether the FDIC owns the site and the manner that the collateral is to be sold (i.e., if the collateral is to be sold in an auction, it may need to be removed in order to be placed on the auction lot).

Depending upon the circumstances, the FDIC takes various steps to secure its collateral. For example, the FDIC may place a fence around property to keep trespassers off the site, may post notices to warn individuals that hazardous substances may be present or may hire security guards to safeguard the premises.

Q.6. <u>The "innocent landowner" provisions were added to Superfund in 1986 to create incentives for the conduct of environmental audits at the time of real estate transfers. Does anyone think this incentive should not exist? What would happen to this incentive if the lending community were exempted from liability? Why shouldn't the lending community put its weight behind such an incentive?</u>

A.6.

CERCLA has been effective in sensitizing the lending community to the risks of hazardous substance liability. However, strict liability for current owners of contaminated properties who were in no way responsible for the release of the hazardous substance may no longer be appropriate. Strict liability may particularly be inappropriate for those who not only did not cause the contamination but also acquired the property through means such as foreclosure. This is especially true for the FDIC, which acquires property pursuant to statutory mandate.

Business realities may now provide sufficient incentives to the lending community to influence their performance of appropriate

environmental audits, irrespective of the "innocent landowner" provision of Superfund. This is because hazardous substance liability may have an enormous effect on a borrower's ability to repay the lender and on the value of the lender's collateral. As a result, the lending community has a strong bottom-line incentive to investigate a borrower's operations at the commitment stage and before closing the loan.

Since case law in this area has now developed so as to hold lenders liable even when they do not hold legal title to the contaminated property, environmental audits are perhaps no longer the panacea for Superfund liability risks as they once were. As provided in CERCLA, a lender may be held liable if the lender is found to be an "operator" of the property, and the courts are construing "operator" broadly. In addition, another basis for potential liability has been signaled by Fleet Factors, where the court indicated that a lender could be held liable merely on the basis of its ability to influence a borrower's decisions involving hazardous substances. Thus, a lender's risk of incurring environmental liability is only partially diminished by the lender's performance of environmental audits at the time of transfering property.

In summary, we suggest that consideration be given to directly modifying the liability provisions that affect current owners of contaminated property, rather than further modifying such liability through provisions such as the innocent landowner defense.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM
**CHARLES M. MITSCHOW**

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August 16, 1990

Ms. Lory Breneman
Chief Clerk
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, DC 20510-6075

Dear Ms. Breneman:

The following is ABA's response to the questions presented by the Senate Banking Committee to Charles Mitschow on the July 19 hearing on S. 2817.

<u>Questions from Senator Donald W. Riegle, Jr.</u>

Q. 1. What are the different types of environmental risks that lenders now must consider?

A. 1. There are four risks to lenders:

a. The lender will not be repaid by the borrower;
b. The value of the collateral will be impaired;
c. The lender's security interest will be impaired; and
d. The lender will be liable for cleanup costs.

Q. 2. What actions have lenders taken to protect themselves against liability or loss due to environmental risks?

A. 2. Lenders are performing environmental due diligence in financial transactions. In addition, lenders are attempting to look to other than real estate to serve as collateral. Finally, lenders are walking away from loan transactions which are too environmentally risky.

Q. 3 What protections against such liability or loss do lenders customarily include in their loan documentation?

A. 3. Any protection that was placed in a loan document for lenders is now moot due to the decision in <u>Fleet Factors</u>. Thus, if the lender addresses the treatment of hazardous wastes <u>in any way</u>, the lender may be held to have "the capacity to influence" the borrower.

Q. 4. Do larger banks manage environmental risks differently than smaller banks? What are the differences?

A. 4. Generally, larger banks have responded by requiring more extensive environmental investigation than community banks That distinction, however, goes to one of the important problems: the size of the borrower or the size of the loan has nothing to do with the size of the environmental problem. Small transactions cannot support extensive environmental due diligence, even though the cost of cleaning up a problem could be far in excess of the size of the borrower or the loan.

Q. 5. The testimony before the Committee as well as the House Committee on Small Business appears to indicate that community banker-type of lenders are experiencing the greatest difficulty in underwriting loans at reasonable cost in the face of environmental risks What possible responses to this difficulty have community bankers developed or identified under current law other than cessation of lending activity.

A. 5. Community bankers have begun creativity categories of "undesirable borrowers" due to the fact that no amount of due diligence, at any cost, can guarantee protection.

Q. 6. What data are available to the ABA regarding lenders' realization of liability or loss due to environmental risks? If data are available, please provide separately the data regarding loss or liability under the Federal and State Superfund laws.

A. 6. I am aware of extensive anecdotal data of transactions where the lender walked away or was hit with unfair environmental liability. In a book entitled, "Environmental Due Diligence: The Complete Resource Guide," a survey of approximately 20 of one firm's clients who reported on 300 multi-million dollar transactions completed during 1988 showed that of those transactions, the clients believed that 70% were environmentally risky.

Q. 7. What environmental risks are lenders able to minimize or avoid through private insurance? Is there any likelihood of insurance coverage increasing in the future?

A. 7. We are not aware of any currently available insurance products which would protect lenders. There has been some mention made of a California company which is only considering pollution-type policies for lenders. There are pollution policies available to borrowers from something called Planet Insurance, but those policies are usually very expensive and have low limits. In our experience, requesting the borrower to obtain such pollution coverage is uneconomic and impractical. There may be some insurance coverage in the future which will be geared toward paying the remaining amount due under a mortgage, in the event of pollution. Again, all of the

projects to produce such insurance products contemplate limits that are far too low to be helpful. Generally, these policies cover the risk that there was pollution on the property prior to the time the lender made its loan; other than the Planet policies, we are not aware of any insurance coverage for the borrower's ongoing operations.

Q. 8. When lenders sell whole loans or securitize a pool of loans or otherwise enter into secondary market transactions involving loan assets, what environmental risks, if any, are passed to the purchaser of the loan or loan-backed security? What are the typical written understandings regarding recourse against the selling bank in the event of realization of an environmental risk that may affect the loan or loans sold or securitized?

A. 8. None. All of the loan pools we are aware of, including the approach of Fannie Mae and Freddie Mac is that the originating lender will indemnify them or allow them to put the property back to the originating lender.

Q. 9. Do State laws that give State authorities a first priority lien -- or "superlien" -- to secure the State's recoupment of hazardous substance cleanup costs create risks of loss to lenders that exceed the risks of lender liability under the Federal and State Superfund laws? Is this the case for those lenders that have a substantial aggregate loan volume secured by assets in "superlien" States?

A. 9. ABA believes that federal law could be interpreted so as to permit a superlien for federal government cleanup so the liability between state and Federal law is not the major issue.

Q. 10. If S. 2827 were enacted into law, how would lenders that have instituted careful environmental risk assessment procedures revise those procedures in undertaking their loan underwriting, monitoring and collection activities?

A. 10. It should not affect business practices of lenders. Lenders are already concerned about the borrower's ability to repay, the value of the collateral, and the priority of their security interest. This bill would simply protect against the last, and least quantifiable, risk of lender liability. There had been little likelihood EPA will issue such guidance but, recent testimony before the House Energy and Commerce Committee by EPA gives us hope that some guidance might be forthcoming.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR GARN FROM
**CHARLES M. MITSCHOW**

Q. 1. Mr. Strock testified that under the CERCLA liability scheme, lending institutions generally are not liable parties. He noted that the "innocent landowner" defense was added during the reauthorization process. In the course of the hearing, Mr. Strock committed to work with affected parties to clarify the applicability of the "innocent landowner" defense.

Mr. Strock also indicated the EPA's intent to issue guidance on the definition of "participating in the management of a facility" under the secured creditor exemption definition of "owner or operator".

What guidance would banks need in these tow areas to avoid the potential liabilities raised in your testimony? If such guidance were given by the EPA on CERCLA, to what extent would that solve the problems discussed at the hearing? Would legislation still be needed? If so, in what areas?

A. 1. ABA is pleased that Mr. Strock, on August 2, told the House Energy and Commerce Subcommittee that EPA recognizes the concerns of lenders and will rapidly issue rules and guidance on the secured creditor exemptions as well as defining "participating in the management of a facility."

While this is a major breakthrough, it is imperative that the Committee understand that any EPA guidance will not affect third-party suits, thus legislation is mandatory.

Banks need to be able to able take steps to protect a security interest such as monitoring the borrower s business activities and assets without concern for incurring environmental liability. Similarly, banks need to be able to protect their collateral without fear of becoming an "operator." We believe that legislation is needed to clarify the current state of the law as the court decisions have strayed too far form the legislative intent of the drafters of CERCLA. In particular, the secured creditor exemption definition of "owner or operator" must be clarified to exclude lenders and corporate fiduciaries from liability.

Q. 2. Mr. Roberts expressed concern at the hearing that lenders would not have sufficient incentives to undertake environmental due diligence prior to making a loan if they did not face potential liability for cleanup under Superfund. For example, Mr. Roberts testified that primary lenders would have little incentive to guard against major liabilities affecting wither the borrower or the collateral because many loans are resold on the

secondary market. Do you agree with Mr. Roberts, either about the impact of th secondary market or on the existence of economic incentives generally? If S. 2827 were to become law, leaving aside the requirement that such audits be done, what would be the economic incentives for lenders to continue to conduct environmental audits?

A. 2. Mr. Roberts' testimony was misguided. The majority of small businesses do not last longer than 5 years and 40% of those businesses fail. Therefore, since most are collateralized by real estate, any prudent lender would be taking a great chance by not performing due diligence in the form of environmental audits.

Economic incentives for lenders will continue to exist first and foremost, because the existence of contamination requiring clean up imposes financial liability on borrowers which might threaten their ability to repay their obligations to a lender. Second, the existence of an environmental condition upon the premises mortgage to a lender would chill the market value of the collateral in the event of foreclosure, thus providing further economic incentives Moreover, if lenders are unable to maximize the value of their collateral because of the potential environmental condition of the premises, lenders will continue to require borrowers to provide evidence substantiated through environmental audits that the premises have no environmental liabilities.

Q. 3. As you are aware, the Office of Thrift Supervision has issued supervisory guidance to thrifts on evaluating environmental risks. What would your comments be if similar guidelines were to be made applicable to banks?

A. 3. The guidelines would be helpful but no administrative rule can assist lenders in suits initiated by third parties.

Individual banks can and should be able to evaluate the effect that specific environmental liabilities would have in connection with a potential loan transaction in the same fashion as they would consider any other liability affecting the borrower or the collateral Once the liability is quantified, the lender can evaluate the credit of the borrower in light of such liability Guidance is needed, however, in the ways that the lender monitors the loan during its term, how the lender may involve itself in the business of the borrower and how the lender may protect its collateral in order to protect itself from incurring uncertain environmental liabilities.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR HEINZ FROM
**CHARLES M. MITSCHOW**

Q. 1. (a) At the underwriting/commitment stage of the loan, do you require all commercial loans to have environmental audits?

A. 1. (a) Marine Midland Banks, Inc. and its subsidiaries and affiliates ("Marine") requires an environmental audit be performed for all loans principally secured by an interest in commercial real property, to borrowers in certain specific industry codes and loans secured by an interest in equipment of inventory which may have hazardous significance.

Q. 1. (b) Do you request the environmental audit?

A. 1. (b) For loans within the above referenced categories, the performance of an environmental audit acceptable to Marine is made a condition to the loan commitment.

Q. 1. (c) What do you require in an environmental audit to make an intelligent decision?

A. 1. (c) Marine requires the environmental consulting firm to (i) perform an on-site inspection, (ii) to review the past history of the site and its uses, (iii) to review the records of the United States Environmental Protection Agency and the New York State Department of Environmental Conservation, or other applicable state or local municipal agencies, to determine whether the site or an adjacent site has a record of environmental contamination or is listed in the CERCLIS list, and (iv) to report to Marine on the environmental condition of the site confirming the absence of or quantifying the limitations of potential environmental liabilities associated with the site or recommending further environmental sampling to confirm the absence of or to quantify the potential environmental liabilities associated with the site.

Q. 1. (d) Do you ever require environmental liability insurance as a loan condition?

A. 1. (d) No. At this point in time, if the environmental audit discloses a potential environmental liability that would rise to the level where we felt we could only protect ourselves by requiring environmental insurance, we probably would not make the loan. It is our understanding that the high cost of liability and property damage insurance covering environmental liability is prohibitive for most of our borrowers.

Q. 2. (a) At the closing stage of the loan, do you use environmental covenants?

A. 2. (a) Yes. Our loan documentation contains environmental covenants, warranties and indemnification provisions.

Q. 2. (b) Do you require separate environmental indemnities?

A. 2. (b) No. Although outside counsel has in some instances recommended the use of separate environmental indemnities and outside counsel may in its discretion, request the execution of same as a condition to closing the loan, our environmental policy does not provide for a document, separate from the loan security documents, which contains an environmental indemnification.

Q. 2. (c) Do you require periodic audits? At whose expense?

A. 2. (c) Yes. All loan renewals, particularly five year term loan renewals, require an environmental audit be performed at the expense of the borrower. In addition, our loan documentation contains covenants which would allow Marine to request periodic audits when Marine deems it necessary, also at the expense of the Borrower

Q. 3. In regard to administering the performing loan , are periodic environmental audits performed? By whom?

A. 3. Certain divisions of the bank require updates every 5 years for all loans in which an environmental audit was initially performed as a condition of closing. Otherwise, unless a specific enviornmental liability is brought to our attention we do not perform periodic environmental audits to administer the performing loan. In all cases Marine's loan documentation requires the borrower to advise Marine of any release of a hazardous substance on or near the site and of any notice violation received by the borrower from a regulatory agency.

Q. 4. With respect to administering a non-performing loan is an in-depth environmental audit performed? When?

A. 4. In administering a non-performing loan , an in-depth environmental audit is performed prior to commencing an action in foreclosure.

Q. 5. During foreclosure and liquidation, do you normally remove collateral from the site? Is it sold? What steps are taken to secure collateral?

A. 5. During foreclosure and liquidation, collateral is generally sold on site if commercially reasonable to do so. The only time collateral would be removed from the site for sale is when there is insufficient collateral to justify a sale on site or such removal is otherwise necessary to conduct a commercially reasonable sale in which case the collateral may be sold off-site with other collateral or if we cannot obtain permission to hold the sale on site for instance, if a landlord will not consent. Generally, to secure collateral, Marine to the extent permitted under law and its agreements, has the locks to the premises changed, maintains the utility service, hires security guards, and prohibits the former owner from access to the site.

Q. 6. The "innocent landowner" provisions were added to Superfund in 1986 to create incentives for the conduct of environmental audits at the time of real estate transfers. Does anyone think this incentive should not exist? What would happen to this incentive if the lending community were exempted from liability? Why shouldn t the lending community put its weight behind such an incentive?

A. 6. Marine agrees that the incentives created by the "innocent landowner" provisions are valid, however, the case law interpreting the statutory scheme has effectively taken this defense away from prudent lenders acting without culpability who may incur clean-up liability far in excess of the amount of the loan transaction. In particular, the decision in the Fleet Factors case has imposed operator liability upon a lender who was not proven to be the actual operator of a facility. On the one hand, the statutory scheme protects a lender who does not operate a facility and on the other hand, the case law imposes operator liability upon a lender if it could have influenced the facility's treatment of hazardous substances which necessitates the inference that the lender, to protect itself, must become actively involved in the day to day business operations of the facility in order to determine whether the facility is in compliance with environmental laws. Lenders do not have the expertise to perform this policing function and we do not feel that the drafters of CERCLA intended lenders to assume this role. Even if the lending community is exempted from liability of the type imposed by Fleet Factors, there would continue to be incentives for the lending community to investigate the environmental condition of the site prior to entering into the loan transaction without the responsibility to police the environmental condition of the site throughout the loan term.

# ENVIRONMENTAL DEFENSE FUND

1616 P Street, NW
Washington, DC 20036
(202) 387-3500

September 5, 1990

Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

Honorable Jake Garn
Ranking Minority Member
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

Re: S. 2827

Dear Chairman Riegle and Senator Garn:

The Environmental Defense Fund was pleased to participate in the Committee's hearing on July 19, 1990, to review the impact of S. 2827 on lender liability under the Superfund law.

Chairman Riegle and Senator Garn expressed an interest in EDF's responses to a number of specific written questions following that hearing. Enclosed please find our reply to those questions.

If the Committee needs further assistance on this important environmental issue, please do not hesitate to call on us.

Sincerely,

William J. Roberts
Legislative Director

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**QUESTIONS FOR MR. WILLIAM J. ROBERTS**
**FROM SENATOR DONALD W. RIEGLE, JR.**
**HEARINGS ON S. 2827, JULY 19, 1990**

Q.1. Why do you believe that Superfund liability is so essential to credit underwriting that takes account of environmental risks?

A.1. As we noted in our statement, there may be sound business reasons for a lender to carefully and cautiously underwrite environmental risks. However, the experience of the last decade in the S&L industry has made it clear that lenders do not always carefully underwrite such risks. Superfund is essential because it provides an important added incentive for lenders to guard against loans to polluting businesses. The widespread use of environmental audits and other measures provides compelling evidence that Superfund does, in fact, offer this strong incentive.

Q.2. You testified that "because many commercial loans are resold in secondary markets, the primary lending institution may have very little incentive to guard against future environmental liabilities affecting either the borrower or the collateral". You later testified that "[b]anks, savings and loans, and other lenders could easily shift loans secured by potentially contaminated property to secondary markets without risk of liability". Could you explain further the basis for this testimony?

A.2. If the primary lending institution resells its commercial loans on the secondary market, it need only be concerned with potential Superfund liability which may result during the period it holds the loan. Once the loan is resold, the primary lender's involvement and potential liability are eliminated.

For example, if a primary lending institution loaned a business credit for expansion of its facilities secured by the land used for the expansion, it could then resell the loan before any contamination occurred on the secured property. The secondary lender may now be liable for any contamination, even though it probably cannot evaluate the environmental risk underlying the loan to the same extent as the primary lender, especially if the loan is included in a package of loans.

Because the secondary lender does not meet the definitions of a mortgage lender or insured depository institution under S. 2827, it may attempt to protect itself from liability by seeking a warranty from the primary lender for any cleanup costs it is made to pay under Superfund. But, if the secondary lender requires full indemnification, the exemption S. 2827 provides to the primary lender would be effectively nullified.

If the exemption in S. 2827 is extended to secondary lenders as well, then there is little need for a warranty or for environmental due diligence on the part of either the primary or secondary lender, because both primary and

secondary lenders would not be liable under Superfund.

Q.3. You testified as follows:

> Given the protections afforded governmental agencies under current law, it is no surprise that the EPA has never named the RTC or FDIC as a potentially responsible party in any Superfund action. Indeed, it is difficult to imagine a scenario in which these agencies could be liable under Superfund, unless they act imprudently with respect to the property they currently own or operate.

Did the testimony of the FDIC at the July 19 hearing alter your views on this point?

Could you explain more fully the reasons for your views on this point? Also, do your views apply as well to transactions in which the FDIC or the RTC acting in its corporate (i e. non-custodial) capacity acquires a contaminated or potentially contaminated asset?

A.3. The testimony of the FDIC at the July 19 hearing in no way altered our views on this point. FDIC merely raised the specter of *potential* liability in order to seek a total exemption from liability. In their capacity as governmental entities, the FDIC and the RTC are clearly protected under current Superfund law, Section 101(35)(A)(ii).

As to their corporate capacity, FIRREA Title II, Sec. 217(d)(3) states that the RTC when acting as a corporation, shall have all the rights of the Corporation as receiver with respect to any liability assumed. Thus, transfers between the RTC as receiver and the RTC as a corporation do not alter the liability protections afforded under Superfund. Along with the liability protection granted to conservators in Sec. 806 of FIRREA, this seems to provide comprehensive protection.

Certainly these two agencies should not be hampered by liability while engaged in the crucial business of managing failed thrifts and banks, but there is little need for an amendment when current law already provides the necessary protection from liability.

Q.4. What possible alternatives to the current reliance upon strict liability of private parties to help fund the clean-up of hazardous substances would you be able to support?

A.4. Superfund in its present form provides the best system of incentives to ensure that property contaminated by hazardous substances is cleaned up and that activities involving hazardous substances are carefully conducted to avoid the release of such substances into the environment. We see no need to consider alternative forms of liability

It should also be noted that lenders are held to a strict liability standard only if they participate in the management of the borrower. If they acquire contaminated property through foreclosure, they can invoke the

innocent landowner defense, which imposes a standard of liability based on negligence -- not strict liability. A lender can be held liable in a foreclosure situation only if it knew or had reason to know of contamination at the site.

Q.5. Do you similarly recognize a need for clarification of the "innocent landowner" defense that is available under Sections 101(35) and 107(b)(3) of the Superfund law? What administrative clarification of this defense that addresses lenders' current concerns do you believe is legally possible?

A.5. The innocent landowner defense specifically covers those who, at the time the property was acquired, "did not know and had no reason to know" of any contamination or threatened contamination by hazardous substances. This defense covers a variety of situations aside from lender liability, and needs no administrative clarification in its present form.

In our view, efforts at clarification should focus on the secured lender exemption, which was a primary concern of the lending community at the July 19 hearing. This is the primary defense for lenders who only hold a security interest in contaminated property. The complaint that the courts have not followed a consistent standard for determining when financial management activities trigger liability is a valid one. Here, narrow clarification of the due diligence standard by EPA would be the most effective and practical action, which would give lenders the guidelines they need and a consistent standard for the courts to follow.

Q.6. Do you see a substantial risk of delay in-or failure to achieve environmental clean-up, if lenders will not extend credit to enable borrowers, particularly small businesses, to make the capital investments necessary to their compliance with environmental regulations?

A.6. Superfund, by its terms, can impose liability only when contamination presents an "imminent and substantial danger to the public health and welfare." To the extent a small business takes steps to prevent or curtail contamination *before* it poses an "imminent and substantial" danger, the business avoids liability. Similarly, a lender providing the financing for such measures has no reason to fear liability, particularly if the proposed expenditures will prevent or curtail contamination.

Certainly, EDF supports efforts by businesses of all sizes to improve waste management practices, and we support lender financing of those efforts. But, given that the risk of Superfund liability is *lessened* by such expenditures, we see no reason to *expand* the protection for lenders from liability.

QUESTIONS FOR WILLIAM J. ROBERTS
FROM SENATOR GARN
JULY 19, 1990

Q.1. What is the feasibility of adjusting rates or fees to take account of liabilities that were not discoverable or quantifiable through due diligence at the time of underwriting the loan? In particular, how can financial institutions appropriately "cost" risks that might far exceed the amount of the loans involved?

A.1. Assessing potential liabilities which remain undiscovered or unquantified after due diligence has been performed is, of course, uncertain at best: but it is important to remember that present law does not create liability for "undiscoverable" risks under Section 101(35)(A) of CERCLA. If a risk is unknown and unknowable to the lender, the lender can invoke the innocent landowner defense and escape liability.

Difficulties in quantifying environmental risk are at least partly due to the comparatively new and evolving methods upon which due diligence is based. The American Society of Testing and Materials is presently engaged in developing standards for conducting environmental audits, which will go a long way towards simplifying the task of environmental due diligence, and testing techniques can be expected to improve constantly. The best way to "cost" potentially high risks is to minimize the chance of liability actually attaching through proper due diligence and careful adherence to EPA guidelines on permissible involvement in management during work-out.

Q.2. You testified that if S. 2827 were to become law, primary lenders would have little incentive to guard against major liabilities affecting either the borrower or the collateral because many loans are resold on the secondary market. Your testimony assumes, among other things, that the secondary markets do not or would not require warranties or recourse rights or agreements that would be applicable in the event of losses associated with environmental risks. Please supply for the record the information on which this assertion is based. Please include in your response and explanation of why you believe that the secondary markets have not or would not act to require the originators to bear losses if loans purchased were not as warranted.

A.2. First of all, it is important to understand that a warranty imposed by a secondary lender will not protect the secondary lender from liability under Superfund; Section 107 (e)(1) disallows any agreement which shifts liability from a potentially responsible party. Even if a warranty were used by the secondary lender to ensure reimbursement of cleanup costs by the primary lender, the benefit of the exemption for a primary lender would be effectively lost whenever a loan was resold with such warranties. The primary lender could be liable for cleanup costs through a contribution claim by secondary lenders, rather than directly from EPA or state enforcement officials.

If the exemption from liability afforded in S. 2827 were extended to secondary lenders, then Superfund liability would be a concern only if it affected the borrower's ability to repay the loan, i.e., it would be treated the same as any other type of potential liability affecting the borrower. In that case neither lender would have any incentive to undertake more than a rudimentary investigation of environmental risk, as only the most egregious releases would represent a potential difficulty.

After surveying a number of sources, EDF has found no examples of secondary lenders who currently require environmental warranties from their primary lenders. It would seem an unecessary complication to incorporate a warranty scheme into loan reselling, especially when such a scheme is likely to have negative effects on both protecting lenders from liability and maintaining incentives to conduct responsible environmental due diligence.

Q.3. In your testimony, you questioned the enforceability of the due diligence requirements in S. 2827. As you know, S. 2827 amends the Federal Deposit Insurance Act which gives the federal banking agencies extensive supervisory and enforcement powers. For example, parties that violate laws, rules, or written agreements are subject to civil penalties that may go as high as $1 million per day. Moreover, any action that constitutes an unsafe or unsound banking practice is subject to sanctions, even if no rule or order is violated. Lenders who are not under the banking agencies do not even come within the scope of the bill at all unless they comply with the environmental due diligence requirements. Please provide the basis for your view that the existing supervisory and enforcement powers would not apply to environmental due diligence required by the appropriate regulator.

A.3. It is not the ability of the Federal banking agencies to bring strong enforcement mechanisms to bear that is questioned, but their ability to apply them to all loan situations and to vigorously enforce them, given their many priorities. It is not at all clear whether the banking agencies have jurisdiction over several of the fiduciaries exempted under S. 2827, such as mortgage lenders, trustees and executors.

It is likewise uncertain what legal force the due diligence requirements mandated by S. 2827 would have. The language of Sec. 35 (e) of the proposed amendment states that the banking agencies shall "develop and implement adequate procedures to evaluate potential environmental risks." Such procedures may or may not be the same as "rules or written agreements" under the Federal Deposit Insurance Act and may not be considered by those agencies to constitute "unsafe or unsound" banking practices.

Finally, the Committee should consider the added workload careful enforcement of such requirements would have on the regulatory agencies. Considering the vast number of loans with potential environmental liability which are made each year, the task of ensuring a high level of compliance by lenders will be highly unlikely. To place this task with the federal banking agencies at a time when their resources are being stretched to the limits with the S & L crisis not only creates a further source of strain, but threatens to

result in an insufficient supervision and enforcement program being brought against lenders and a depleted ability of the agencies to perform their other primary responsibilities.

Q.4. You also indicated your concern about whether the banking agencies were the appropriate parties to develop the procedures for the due diligence required as part of the lender's loan underwriting At the hearing you indicated that you were familiar with the supervisory bulletin from the Office of Thrift Supervision. Do you believe that the underwriting standards set forth in that bulletin are appropriate? What changes or revisions would you recommend for the environmental due diligence lenders would be required to perform?

A.4. Having the federal banking agencies develop a complete set of due diligence procedures in addition to EPA's current guidelines would only be redundant. The EPA is already working with the banking community to clarify and improve on its existing guidelines, and these should be suffiently clear so that no additions will be needed. We believe that the standards set forth in OTS Thrift Bulletin 16 seem to be concerned more with the specific procedures which banks might adopt in order to meet due diligence requirements. As such, it seems a worthwhile supplement to EPA guidance.

Q.5. If a lender has undertaken an environmental audit before making the loan, has not been involved in release of hazardous waste, and forecloses on a loan (or accepts a deed in lieu of foreclosure) after the borrowers default, do you believe that the innocent landowner defense in CERCLA should be available to the lender?

A.5. If the lender in this situation has undertaken sufficient due diligence, no liability should attach for a release which the lender had no reason to know of The question is whether "sufficent due diligence" requires only an audit prior to the signing of the loan, or whether ongoing inspections throughout the period the loan is held are necessary. This appears to be a procedural question rather than a substantive one. OTS Thrift Bulletin 16 suggests in number 3 of the section titled Purpose of Environmental Risk Policy that ongoing property inspections and monitoring are needed, but this may depend on the circumstances of the individual loan. Over time, this question can be settled to a high degree of certainty without any recourse to modifying the innocent landowner defense itself.

Q.6. In your testimony you give the example of a bank purchasing a hazardous waste transportation company which hauls waste from generators to dumpsites. Under what circumstances would this be a legally permissible acquisition and operation for a bank in light of the restrictions in the Bank Holding Company Act the National Banking Act, and federal banking regulations limiting non-banking activities?

A.6. Such provisions do provide restrictions on the activities of certain banks, but S. 2827 also provides an exemption for any "mortgage lender," which is defined in Section 35. (a)(2) as "a person who is regularly engaged in the business of making extensions of credit secured, in whole or in part, by real

property to nonaffiliated parties," so long as such persons comply with the due diligence requirements outlined in subsection (e) of the Bill.

This definition appears to include a wide range of lenders who may not come under the scope of the laws and regulations applied to banks. In addition, the actual language of the exemption in subsection (b)(2) includes property "held in a fiduciary capacity," which is defined as including "acting as trustee, executor, administrator, custodian, guardian of estates, receiver, conservator", etc.. It is unclear whether the restrictions on banking activities would apply to all of these situations. In fact, it is impossible to ascertain before the fact what potential business combinations may be feasible which might allow a polluter to take advantage of these definitions and escape liability.

Q.7. In the hearing you indicated your concern that polluters might find loopholes through which they could avoid liability. As I made clear in the hearing, I agree completely that polluters should pay. While I believe that the current language achieves this result, I would welcome and consider your specific language directed at ensuring that no such evasions occur.

A.7. The fairly wide definitions mentioned in Answer 6 above demonstrate loopholes already in S. 2827. Although some of these provisions could be narrowed, we believe that the strict liability standard of CERCLA depends on there being few and narrow exemptions. Any attempt to create a 'safe harbor' for an entire class of potential defendants, such as banks, is inherently susceptible to overinclusion. The best way to prevent loopholes is simply not to create one for lenders in the first place, but to strengthen the existing defenses and clear up inconsistencies and ambiguities which have developed since CERCLA's passage.

# ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

ABC
ASSOCIATED BUILDERS AND CONTRACTORS, INC.

TO: Ed Malan

FROM: Marc Freedman, Associated Builders and Contractors Marc

RE: Statement to be inserted into record

DATE: July 18, 1990

Enclosed is ABC's written statement to be inserted in the record for the hearing on lender liability scheduled for tomorrow, July 19. We will not be presenting a witness, this is our only statement.

Please call me or Mike Bolen at 637-8800 if there are any questions. Thank you for your assistance.

729 15th Street, NW • Washington, DC 20005 • (202) 637-8800

# Statement of Associated Builders and Contractors

THE IMPACT OF LENDER ENVIRONMENTAL LIABILITY

on

CONSTRUCTION FINANCING

submitted to

BANKING, HOUSING, AND URBAN AFFAIRS COMMITTEE

UNITED STATES SENATE

JULY 18, 1990

**Speaking for the Merit Shop**

729 15th Street, N.W.
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Associated Builders and Contractors (ABC) presents this statement to discuss its concerns not just for the financial community but for a segment of the small business community which depends greatly on reasonable access to capital financing--the small businessmen and women who are builders and contractors.

Contractors are second tier players in this problem but are clearly affected nonetheless. When environmental problems arise with regard to a commercial site and the financing falls apart, can't be obtained or is rescinded, more than the lender, buyer and seller are affected. Often the contractor who has agreed to build the project for the buyer or developer also loses. And, unfortunately it is often the contractor who loses the most.

The following scenarios will help illustrate the dimensions of this problem as it relates to contractors

A developer may wish to purchase a piece of property for development as a small industrial park or retail strip center. The developer will sign a purchase agreement with the seller and will obtain a financing commitment from a lending institution to finance the construction of the project. The permanent financing on the construction has not yet closed; among other things the permanent financing is conditioned on the receipt of a favorable environmental assessment.

In the meantime, the developer contracts with a general contractor for the construction of the buildings and site preparation. In the real world, the contractor is often requested or pressured by the developer to begin construction prior to the final approval of the construction loan. Most contracting jobs have tight time schedules, often with penalty clauses for missed deadlines. Construction projects are very time sensitive and usually very competitive. Should the contractor decline to begin the work prior to the construction loan being closed, he will find his job in the hands of his competitor.

So the contractor begins work, dedicates his time and resources and enters into contracts with his subcontractors. In some cases he may need to secure financing for extra equipment or supplies as well. Then the environmental assessment report is returned and it reveals that a very small portion of the property was once contaminated with PCBs. Although the dump site has been cleaned up the lender refuses to proceed with the loan because of his concern for CERCLA or RCRA liability. PCBs are an obvious case of an environmental hazard, however, lenders have been known to pull out for less severe reasons such as a leaking underground storage tank and concerns over the handling of waste oil.

While environmental assessments are becoming commonplace, indeed most attorneys routinely recommend that their clients involved in land transactions have them done, the consequences of these studies and the conclusions being drawn from them are a serious issue. Banks and other lenders are making prudent decisions in not proceeding with loans which might expose them to CERCLA or RCRA liability. Unfortunately, the bottom line is that

construction and other small businesses in general are denied the necessary capital.

The result of all this is that the owner in the above scenario now has no money to pay the contractor The contractor thus becomes the biggest loser. He loses the profits on the job and, because he dedicated resources, he must absorb all construction costs and the loss of any other funds invested outright. He now has no place to turn until another job comes along. Equally significant, his employees have no work and his subcontractors and their employees have no work. Furthermore if the owner was a small business, perhaps an operator of gas stations or a dry cleaner seeking to expand, their business is curtailed as well. Because contracts have been signed, potential for litigation is great and additional dollars are spent either attempting to negotiate a settlement or in arbitration.

What has just been described is an actual construction industry scenario. It is a tragedy not only for the lender and borrower, but obviously for the small business contractor, his employees and their families

Current legal interpretations of CERCLA on the lender liability issue have placed the lender in the position of the owner. ABC believes this is wrong. No commercial lender wants to be an owner. More importantly, no owner wants his lender to run his business for him. CERCLA, however, has put the lender in the untenable position of being liable for his customer's hazardous waste practices and other environmentally sensitive practices The lender becomes at a minimum, much more cautious and conservative in his lending. This results in the cost of a typical financing being increased as much as $10 000 or more (the bankers do not absorb the cost of the environmental assessments). This may result in closings being delayed or cancelled with the ripple effect hitting the contractors.

The need for legislation such as S. 2827 and S. 2319 and H.R. 4494, has been brought home by a recent decision a case of first impression from the Eleventh Circuit Court of Appeals The opinion in the Fleet Factors case held that a lender was liable under CERCLA because of the lender's participation in the financial management of the facility to a degree which indicated the lender's capacity to influence the owner's treatment of hazardous waste. In other words, if a lender participates in the financial--as opposed to operational--management of a facility to the extent that it could affect hazardous waste disposal decisions there may be liability to the lender. Thus, the lender with the mere authority to influence a decision regarding waste can now be held strictly liable under CERCLA. In real terms this means every lender can be liable as they can always use that leverage to direct or influence the activities of the borrower.

This decision has sent tremors through the financial community. It will not only tighten credit availability for developers and contractors and other small businesses but it will make what credit will be available more expensive.

ABC supports these efforts to bring some rationality and

reasonableness to this issue. S. 2827 and S. 2319 and H.R. 4494 are sound pieces of legislation. They are reasoned approachs to the solution of a difficult problem which affects small businesses everywhere.

Testimony by

The Bank Lessors Group

on S. 2827

Submitted to the
Committee on Banking, Housing,
and Urban Affairs
U.S. Senate

July 19, 1990

Thomas H. Milch, Esq.
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Attorneys for the
Bank Lessors Group

Testimony by the Bank Lessors Group

on S. 2827

Submitted to the
Committee on Banking, Housing,
and Urban Affairs
U.S. Senate

July 19, 1990

The Bank Lessors Group is an ad hoc group of bank affiliated leasing companies that was formed to monitor legislative and regulatory developments affecting leasing activities of federally regulated banking organizations.[1]

The Bank Lessors Group is pleased to submit this written testimony in support of Subtitle B of S. 2827 introduced by Senator Garn to clarify that financial institutions whose activities do not cause or contribute to environmental contamination are exempt from liability under federal and state environmental hazard laws, including the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA"). The Bank Lessors Group commends the Committee on Banking,

1 The Bank Lessors Group includes leasing companies affiliated with the following banks Bank of New York, Bank of Tokyo, Chase Manhattan Bank, N.A., Citibank, N.A., Continental Bank, N.A., First National Bank of Boston Mellon Bank, N.A., NCNB Texas National Bank, Pittsburgh National Bank, Security Pacific National Bank, U.S. National Bank of Oregon.

Housing, and Urban Affairs for holding hearings on this important legislation.

S. 2827 would specifically exempt depository institutions and their affiliates from CERCLA liability resulting from the acts of others in connection with certain commercial lending, trust, and leasing activities. The Bank Lessors Group strongly supports this legislation as necessary to clarify the exempt status of federally regulated depository institutions in connection with their passive financing activities in accordance with the original intent of Congress in enacting CERCLA.

The Bank Lessors Group particularly supports the provision in S. 2827 that would clarify the exempt status of bank affiliated leasing companies that hold title to property in connection with a lease subject to regulation by federal or state banking authorities. Although the legislative history of CERCLA demonstrates that such lease financing activities were intended to be exempt under CERCLA, recent court decisions and actions by the Environmental Protection Agency have raised considerable doubt as to whether such activities are protected in fact.

Under some interpretations of the law, bank leasing companies may be exposed to significant potential liability under CERCLA as a result of holding

title to property and equipment solely for the purpose of financing the acquisition and use of such property and equipment by third party lessees. In the attached appendix, we review the relevant case law under which bank leasing companies have become vulnerable to CERCLA liability for the acts of their lessees or others.

A lease is regarded as the functional equivalent of a loan for purposes of the federal banking laws regulating bank lending activities.[2] In a typical lease financing, the customer will select specific property or equipment for use in its business operations. For tax and other business reasons, the customer may choose to acquire the property by leasing it rather than purchasing it. As a means of financing the acquisition of the property for lease, the customer will request a bank to purchase the property and lease the property to the customer. In other cases, the customer may wish to engage in a sale and lease back of existing assets in order to raise additional funds for working capital and will request bank lease financing.

In order to achieve the desired tax and other benefits of the transaction, the bank will hold title to the property but, during the term of the lease, as in a lending transaction, will not possess or have any other

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[2] _See_ 12 C.F.R. 7.3400(g); 12 U.S.C. 84, 371c.

interest in the property other than as collateral. The lessee typically will operate, manage, maintain, possess, and insure the property as if it were the owner of the property. Indeed, under federal banking laws, bank leasing companies may not operate or manage leased property and are prohibited from providing any maintenance, servicing, or insurance of leased property during the lease term. See 12 C.F.R. 7.3400 and 12 C.F.R. 225.25(b)(5).

Bank lessors typically will seek to protect the value of the collateral to which they hold title, as well as guard against CERCLA liability, by using the same precautionary testing, evaluation, representations and warranties, monitoring, and inspection requirements which may be required of a borrower by a lender. Nevertheless, there is no assurance to the lessor that contamination of equipment or a facility may not be overlooked or concealed.

Although leasing companies may be eligible in some circumstances for the "innocent landowner" exemption under CERCLA, that exemption has been very narrowly construed in the case law to date and does not apply to leases of personal, as opposed to real, property. Moreover, while a bank lessor certainly should be entitled to the "security interest" exemption under CERCLA because it holds title to leased property

primarily to secure its interest in the property, the courts to date have not recognized this exemption for leasing activities under CERCLA, and the Environmental Protection Agency has argued strenuously for a very narrow reading of the "security interest" exemption. Thus, bank lessors may be exposed to significant potential CERCLA liability if Congress does not act to clarify the law.

The House Small Business Committee has heard dramatic and convincing evidence that bank lenders may be unwilling to provide financing to small businesses located in areas where a possibility of hazardous waste contamination exists or may be reluctant to lend to small businesses to finance industrial facilities due to potential CERCLA liability. For many of the same reasons, bank leasing companies are becoming unwilling or reluctant to provide lease financing to certain types of lessees or for certain types of property and equipment without clear CERCLA protection.

Lease financing has become a major substitute for commercial lending during the past twenty years and is an increasingly important part of the business of banking. The leasing industry accounts for almost one third of all capital investment in the United States each year. More new equipment is financed in the United States through leasing than through any other financing

means except the bond market. In 1989, approximately $130 billion in new equipment was financed by leasing transactions. Bank leasing companies acted as lessors in approximately 30 percent of these transactions.

The threat of substantial and unpredictable liability under CERCLA not only inhibits bank leasing transactions with certain classes of customers but also poses increased risk of loss to the federal deposit insurance system. A bank leasing company that incurred major CERCLA clean-up costs could be forced to look to its parent bank or bank holding company for funds to pay the liability, thereby weakening the entire banking organization and increasing the potential liability to the federal insurance fund. The amount of CERCLA costs imposed on a leasing company would not be limited by the company's size or the amount of the lease by which it acquired ownership to the contaminated property.

The legislative history of CERCLA indicates that Congress intended to provide an exemption for lease financing activities. The definition of "owner" was stated to exclude persons possessing indicia of ownership in connection with a leasing transaction:

> Owner . . . does not include certain persons possessing indicia of ownership (such as a financial institution) who, without participating in the management or operation of a . . . facility, hold title either in order to secure a loan or in connection with a lease financing

> arrangement under the appropriate banking laws. For example, a financial institution which held title primarily to secure a loan but also received tax benefits as a result of holding title would not be an "owner" as long as it did not participate in the management or operations of the . . . facility. (Emphasis added.)

1980 U.S. Code Cong. & Ad. News 6119, 6181-82, quoting from H. Rep. No. 96-172, 96th Cong., 2d Sess. 36-37 (1980). Nevertheless, leasing companies have been identified by the Environmental Protection Agency as potentially liable parties under CERCLA for environmental clean-up costs where the lessor apparently had no role in the operation, management, or supervision of the leased property or equipment. See Voluntary Purchasing Groups Inc. v. EPA, 889 F.2d 1380 (5th Cir. 1989).

Congress recognized the limited role that lessors play in financing equipment and other property when it exempted them from liability in connection with nuclear incidents in the Price Anderson Amendments Act of 1988. That Act provides that

> No person under a bona fide lease [of a nuclear facility] . . . shall be liable by reason of an interest as lessor . . . for any legal liability arising out of or resulting from a nuclear incident resulting from such facility unless such facility is in the actual possession and control of such person at the time of the nuclear incident . . . .

42 U.S.C. 2210. For the same reasons that Congress exempted leasing companies from liability under the Price Anderson Act, such companies should be exempt under CERCLA.

S. 2827 would relieve bank leasing companies and other depository institutions from exposure to unwarranted CERCLA liability without lowering overall environmental protection standards. Leasing companies will continue to require lessees to observe strict precautionary measures to avoid environmental hazards in order to protect the underlying collateral to which they hold title. By making borrowers and lessees bear the financial burden of CERCLA liability rather than sharing such liability with an innocent "deep pocket" financial institution, S. 2827 will increase the incentives for borrowers and lessees to employ better safeguards in their handling of toxic materials.

Moreover, S. 2827 would protect bank leasing companies only if they are not responsible for causing or contributing to environmental contamination. If a bank leasing company is found to have caused or contributed to contamination subject to CERCLA clean-up, it will not be relieved of CERCLA liability under the bill. Bank leasing companies, as other exempt lending institutions, would continue to bear the cost of CERCLA clean-ups for which they are responsible.

Based on the foregoing, the Bank Lessors Group strongly supports Subtitle B of S. 2827 as necessary to clarify the protected status of bank-affiliated leasing companies by providing a clear exemption from CERCLA for such companies that do not cause or contribute to CERCLA contamination but merely act as passive financiers.

APPENDIX

To Testimony by

The Bank Lessors Group

on S. 2827

Submitted to the
Committee on Banking, Housing,
and Urban Affairs
U.S. Senate

July 19, 1990

<u>Relevant CERCLA Case Law</u>

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## Relevant CERCLA Case Law

When Congress enacted the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA"), it included an exemption to protect certain lending institutions from liability for the actions of their borrowers. Normally, under CERCLA, any owner or operator of a facility from which there has been a release or threatened release of a hazardous substance may be held jointly and severally liable for the costs of responding to the release. However, CERCLA exempts from the class of potentially liable owners and operators:

> "a person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility."[1]

The legislative history of CERCLA demonstrates that Congress intended this exemption to include bank leasing companies. The history states that:

> "[The term 'owner'] does not include certain persons possessing indicia of ownership (such as a financial institution) who, without participating in the management or operation of a vessel or facility, hold title either in order to secure a loan <u>or in connection with a lease financing arrangement under the appropriate banking laws</u>, rules, or regulations

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[1] CERCLA § 101(20)(a); 42 U.S.C. 9601(20)(a).

> . . . . For example a financial institution which held title primarily to secure a loan but also received tax benefits as the result of holding title would not be an 'owner' as long as it did not participate in the management or operation of the vessel or facility."[2]

In practice, however, the U.S. Environmental Protection Agency ("EPA") has interpreted the secured creditor exemption much more narrowly than Congress intended. In response to EPA's interpretations, a number of judicial rulings have failed to give full effect to the Congressional intent behind the exemption. Most significantly, the first federal appellate opinion on the secured creditor exemption, the Fleet Factors decision handed down last month, may prove to have greatly eroded the scope of the exemption altogether.

The effect of the case law to date is to force commercial lenders and bank lessors to make business decisions on the assumption that they are fully at risk of Superfund liability for the acts of their borrowers and lessees. The case law suggests that a secured creditor can be confident of avoiding liability only by declining to make loans to businesses with environmental risks unless the borrower is so large and stable that there is no risk of insolvency, or by refusing to assist

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[2] H. Rep. No. 96-172, 96th Cong., 2d Sess. 36 (1980), Report of the House Merchant Marine and Fisheries Committee. (Emphasis supplied.)

a troubled borrower and forfeiting the collateral if the borrower slips into bankruptcy.

<u>The Secured Creditor Exemption</u>

The first major case interpreting the secured creditor exemption was <u>United States</u> v. <u>Mirabile</u>.[3] A bank had assigned one of its employees to monitor the operations of a facility on which it had a security interest after the borrower began to experience financial difficulties. There was evidence that the bank employee visited the facility frequently, played a role in determining the order in which customers' orders would be filled, and insisted on certain manufacturing and personnel changes. The court held that this involvement by the bank in the borrower's operation, if proven at trial, could constitute "participation in the management" of the company, thereby rendering the bank ineligible for the secured creditor exemption and potentially liable under CERCLA.

The <u>Mirabile</u> holding, however, was not entirely unfavorable to secured creditors. The <u>Mirabile</u> court, while holding that one bank defendant could be a potentially liable party, granted another bank defendant's motion for summary judgment. The second bank had foreclosed on the contaminated property, and

3 15 Envtl. L. Rep. 20,994 (E.D. Pa. 1985).

then eight months later -- without taking legal title or conducting business on the site -- assigned its bid to a third party. The court found that the foreclosure did not negate the secured creditor exemption, stating that "before a secured creditor . . . may be held liable, it must at a minimum, participate in the day-to-day operational aspects of the site."[4]

The next major case, United States v. Maryland Bank & Trust Co.,[5] held that a bank which forecloses on property may, as a result of the foreclosure, become liable under CERCLA as an owner. Maryland Bank & Trust foreclosed on a piece of property in which it held a security interest and then repurchased the site at the foreclosure sale. Unbeknownst to the bank, the site had been used for hazardous waste disposal prior to the time that the bank took a security interest. At the time of foreclosure, the site was contaminated. The court ruled

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[4] Id. at 20,996. In another 1985 decision, In re T.P. Long Chemical, Inc., 45 Bankr. 278 1985) a bankruptcy court ruled that the secured creditor exemption protected a bank from CERCLA liability in connection with buried drums of chemicals on the bankrupt debtor's property. The bank held a security interest in all the personal property of the debtor. It was later discovered that the debtor owned buried drums, thus giving the bank a security interest in the drums themselves. The court held that the secured creditor exemption protected the bank from liability in connection with the drums, noting in dicta that the exemption would apply even if the bank had actually foreclosed on the drums.

[5] 632 F. Supp. 573 (D.C. Md. 1986).

that the bank was liable for cleanup costs and that the secured creditor exemption did not apply. Once a secured creditor forecloses on property, the court ruled, it no longer just has a security interest but rather becomes a full owner of the property. This aspect of the Maryland Bank & Trust decision was reaffirmed by a Pennsylvania federal district court in the 1989 case of Guidice v. BFG Electroplating and Manufacturing Co., Inc.[6]

The recent case of United States v. Fleet Factors,[7] the first reported decision analyzing the secured creditor exemption by a U.S. court of appeals, may feature the most restrictive judicial interpretation of the exemption thus far. The Eleventh Circuit held that a secured creditor may incur liability as an "owner" under CERCLA simply by participating in the financial management of a facility "to a degree indicating a capacity to influence the corporation's treatment of hazardous wastes."[8] Under this test, it presumably would not be necessary to show that the creditor actually did influence the facility's

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6 732 F. Supp. 556 (W.D. Pa. 1989).

7 No. 89-8094 (11th Cir. 1990), 1990 U.S. App. LEXIS 8266 (slip op. dated May 23, 1990, as amended May 29, 1990).

8 1990 U.S. App. LEXIS 8266 at 10.

management of hazardous wastes in order to hold it liable, so long as the surrounding circumstances indicate that it could have done so.

Fleet Factors had held a security interest in a textile facility, as well as all of the plant's equipment, inventory and fixtures. The textile firm ceased operations after experiencing financial difficulties and began to liquidate its inventory. EPA alleged that Fleet actively participated in the facility's management during the liquidation stage. According to EPA, Fleet required the plant to obtain Fleet's approval prior to shipping goods to customers, dictated when and to whom the finished goods should be shipped, established prices for excess inventory, determined when layoffs should occur, supervised the activity of the plant office administrator, received and processed employment and tax forms for plant employees, and controlled access to the facility. Fleet also foreclosed on and contracted for the removal of various fixtures, during the course of which fibers were released.

Fleet argued unsuccessfully in the district court that it was exempt from CERCLA liability under the secured creditor exemption. The appellate court affirmed the denial of Fleet's motion for summary judgment, finding that the facts alleged by the

government, if proved at trial, would demonstrate "pervasive, if not complete" involvement by Fleet in the financial management of the facility, and would constitute a basis for CERCLA liability. Although the court rejected the principle that day-to-day management had to be shown to establish liability, it indicated that these facts could constitute evidence of day-to-day management sufficient to establish Fleet's liability even under the Mirabile standard.

However, the court's opinion suggests that a secured creditor's involvement in financial management may fall far short of Fleet Factors' activities and still trigger CERCLA liability. The court indicated that it may be necessary only to show that the secured creditor's involvement with the facility's management was "sufficiently broad to support the inference that it could affect hazardous waste management if it so chose."[9] The court, however, did not specify what would constitute sufficient involvement to support such an inference. In fact, the court went out of its way to emphasize that its decision would not preclude the monitoring of "any aspect of the debtor's business" or involvement in "occasional and discrete financial

9 1990 U.S. App. LEXIS 8266 at 10.

decisions relating to the protection of its security interest."[10]

The decision in Fleet Factors underscores the need for legislative clarification of the secured creditor exemption, since it may be interpreted to leave secured lenders broadly at risk of liability under a hypothetical test involving what the lender "could" have done (as opposed to what it did) to "affect" (as opposed to control) hazardous waste decisions.

Application to Bank Lessors

None of the foregoing cases addressed specifically the issue of the potential liability of leasing companies under CERCLA. However, EPA has indicated that it feels free to name equipment lessors as potentially responsible parties under CERCLA even where their "ownership" interest amounts to nothing more than their status as a passive lessor. In Voluntary Purchasing Groups v. Reilly,[11] EPA apparently made just

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10 Brief for Appellee at 37-43. 1990 U.S. App. LEXIS 8266 (No. 89-8094). It should be noted that, in the Fleet Factors case, EPA had argued for an even more restrictive interpretation of the secured creditor exemption than that followed by the court. In its appellate brief, EPA had asserted that any advice or assistance by a lender to its borrower, regardless of whether it was operational or financial, and even if it occurred only in isolated instances, constitutes "participation in management" and thus should nullify the secured creditor exemption.

11 889 F.2d 1380 (5th Cir. 1989).

this kind of designation of a company that leased certain equipment to a chemical manufacturer that later became insolvent. The lessor alleged that it had no role in the operation or management of the facility and no financial connection other than the lease financing agreement which entitled it to receive, as its rent, a share of any profits produced using the leased equipment.[12] In response to EPA's designation, the lessor filed a declaratory judgment action seeking a determination that it could not be liable as a matter of law.

The court, without reaching the merits of the equipment lessor's claims, dismissed the declaratory judgment case on jurisdictional grounds because of CERCLA's prohibition on preenforcement review. The court ruled that the lessor's defense could only be heard in response to an EPA cost recovery suit, which in fact was filed by the Agency shortly after the lessor's declaratory judgment case was filed.

The paucity of case law dealing specifically with passive lessors does not change, however, the cumulative

12 EPA's reasoning in naming the equipment lessor is somewhat unclear from the court's opinion. It is possible that a factor in the Agency's designation was its allegation that the lessor also was the "owner" of a "processing plant" located at the site, although this charge was vehemently denied by the lessor. In any event, EPA's claims apparently identified the lessor's passive role as "owner" as one basis for liability.

effect of the cases that have been decided. The existing cases dramatically reduce the effectiveness of the secured creditor exemption as a reliable source of protection for financial institutions. If a lender forecloses on contaminated property, it runs a serious risk of losing its protection from liability as a secured creditor. If it attempts to protect its interest by assisting a financially troubled borrower in plant activities, it risks liability for participation in the operational management of the facility. If the lender attempts to assist the borrower in managing its accounts, it risks liability for participation in the financial management of the facility.

Under the relevant case law, bank leasing companies face potential CERCLA liability as owners and operators under the same circumstances as bank lenders. For exemple, if a bank lessor cancels an equipment or real property lease because the lessee is experiencing financial difficulties, it faces the same risks of liability as a bank lender which forecloses on property.

Bank leasing companies, however, face an additional risk of environmental liability which many bank lenders may not face. Rather than merely holding a security interest, bank lessors are the passive but titled owners of the property they lease. Despite the legislative history clearly bringing within the secured

creditor exemption persons possessing indicia of ownership "in connection with a lease financing arrangement under the appropriate banking laws," there is every reason for bank lessors to consider themselves vulnerable under existing case law to possible liability for passive ownership.

It is sometimes posited that bank lessors may escape CERCLA liability under the "innocent landowner" defense. As noted below, however, that defense applies only to owners of real property, and it provides limited protection under current case law.

The "Innocent Landowner" Defense

CERCLA explicitly provides for three affirmative defenses to liability: that the contamination (1) resulted from an act of God; (2) resulted from an act of war; or (3) occurred solely as the result of actions or omissions of a third party, with whom the defendant had no contractual relationship.[13] Under the "third party" defense, the defendant also has to show that "due care" was exercised with respect to the hazardous substance concerned, and that it took "precautions against the third party's foreseeable acts or omissions."

13 CERCLA § 107(b); 42 U.S.C. § 9607(b).

In the early years of the statute, EPA interpreted the third party defense narrowly, arguing successfully, for example, that a purchaser of land could not assert the defense for contamination caused by a prior owner, because the deed for the purchase established a "contractual relationship" between the purchaser and the prior owner. Consequently, innocent purchasers of land faced substantial environmental liability simply because they acquired contaminated property.

As part of the 1986 Superfund Amendments and Reauthorization Act, Congress clarified the application of the third party defense to "innocent landowners" by amending the statutory definition of "contractual relationship." The new law provided that a purchaser of real estate is not to be deemed to have a contractual relationship with a seller (and thus can assert the third party defense) if the purchaser can establish that:

> (1) the purchaser acquired the property after the disposal or placement of the hazardous substance on, in, or at the facility;
>
> (2) at the time the purchaser acquired the facility, the purchaser did not know and had no reason to know that any hazardous substance which is the subject of the release or threatened release was disposed of on, in, or at the facility; and

(3) the purchaser undertook, at the time of acquisition, "all appropriate inquiry" into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability.

(4) the purchaser satisfied third party defense obligations to exercise "due care" and take "foreseeable precautions" with respect to hazardous substances.[14]

The new "innocent landowner" defense, as it is frequently called, was designed in part to relieve from liability financial institutions which might acquire contaminated property through foreclosure.[15] In practice, however, the "innocent landowner" defense has afforded little real protection to financial institutions and provides no protection for many bank leasing companies. The defense is expressly limited to purchasers who acquire real property.[16] National bank leasing companies are prohibited from leasing real

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[14] See CERCLA § 101(35); 42 U.S.C. § 9601(35). This section also protects parties that innocently acquire land through inheritance or bequest and government agencies that acquire a facility by escheat, or through any other involuntary transfer or acquisition, or through eminent domain.

[15] One Bureau of National Affairs report on the 1986 statute stated that Congress created the innocent landowner defense to "mitigate the rule applied in Maryland Bank & Trust and other cases involving unwitting purchases of contaminated property." See Bureau of National Affairs, Superfund II: A New Mandate 28 (1987).

[16] CERCLA § 101(35)(A); 42 U.S.C. § 9601(35)(A).

property as a matter of federal law.[17] For the bank-affiliated leasing companies that do purchase and lease real property for their customers, the defense is too limited to be of widespread applicability.

First, the defense only applies to contamination existing at the time of purchase. If the contamination occurs after purchase, even if the owner had no contact with operations at the site, the defense is inapplicable. Thus, in United States v. Monsanto,[18] the court held that a landowner may be liable for its lessee's mismanagement of hazardous wastes even where the landowner had no knowledge that the lessee had expanded what had been warehouse operations to include hazardous waste treatment and recycling activities.[19]

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[17] Bank leasing companies that are direct subsidiaries of national banks generally are not permitted to lease real property 12 U.S.C. 24 (Tenth), 12 C.F.R. 7.3400. Those that are affiliates of banks and are owned by bank holding companies are permitted to lease real property. 12 C.F.R. 225.25(b)(5).

[18] 858 F.2d 160 (4th Cir. 1988), cert. denied, 109. S.Ct. 3156.

[19] See also United States v. Time Oil, 687 F. Supp. 533 (D. Colo. 1988) (innocent landowner defense does not protect landowner from liability for acts of sublessee). Other recent cases have held that landowners can be liable for environmental damage by their lessees, without making any reference to the innocent landowner defense. See, e.g., International Clinical Laboratories, Inc. v. Stevens, 710 F. Supp. 466 (E.D.N.Y. 1989); United States v. Northernaire Plating Co., 670 F. Supp. 742, 748 (W.D. Mich. 1987), aff'd, 889 F.2d 1497 (6th Cir. 1989).

Second, courts interpreting the defense have taken a rigid approach to the requirement that the landowner exercise "all appropriate inquiry" at the time of acquisition. In Wickland Oil Terminals v. Asarco Inc.,[20] for example, the court held that the purchaser was not entitled to the defense where it had known, at the time of its purchase, that the property contained certain heavy metal-containing slag, but believed that the slag was harmless and inert. The court found that the purchaser's failure to investigate more thoroughly the status of the slag was evidence of a lack of "appropriate inquiry."[21]

Finally, some bank lessors may face difficulty in ever meeting the "due care" and "foreseeable precaution" requirements in connection with their leasing activities because they generally are forbidden, by federal banking

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20 19 Envtl. L. Rep. 20,855 (N.D. Cal. 1988).

21 In a few cases, landowners have been able to avoid summary judgment based on the innocent landowner defense. In United States v. Serafini, 706 F. Supp. 346 (M.D. Pa. 1988), the court denied the government's motion for summary judgment against a landowner who in 1968 had purchased a site at which 55-gallon drums were openly visible. The landowner had not actually visited the site prior to the purchase, or known about the drums. The landowner asserted that a purchaser in his position in 1968, using "all appropriate inquiry," would not have made an actual site visit prior to the purchase. The court's opinion strongly suggested that if, at trial, the defendant could establish that its conduct constituted "all appropriate inquiry" by 1968 standards, it would be able to avoid liability under the innocent landowner defense.

The Chemical Manufacturers Association (CMA) appreciates the opportunity to submit this written testimony on S. 2827, the Federal Deposit Improvements Act of 1990, proposed legislation that would amend the Federal Deposit Insurance Act. CMA is a nonprofit trade association whose member companies represent more than 90 percent of the productive capacity for basic industrial chemicals in the United States. The members of CMA include many companies that are subject to heavy liabilities under Superfund and that therefore have extensive experience in Superfund proceedings.

One effect of S. 2827 would be to exempt the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, other federal banking agencies, insured depository institutions, and other mortgage lenders from potential liabilities under Superfund. CMA appreciates the concern of the sponsors of the legislation that Superfund can operate inequitably to impose liability on parties that do not reasonably appear to be the cause of the conditions found at the various Superfund sites. However, Superfund has led to just this type of inequitable result in many if not most cases, and not just in those cases involving lending institutions. CMA sees no clear or compelling reason to give preferential treatment to lending institutions in contrast to many other groups for which the prospect of Superfund liability is equally -- or even more -- real, threatening, and unreasonable.

CHEMICAL
MANUFACTURERS
ASSOCIATION

WRITTEN STATEMENT
OF THE
CHEMICAL MANUFACTURERS ASSOCIATION

ON

THE FEDERAL DEPOSIT IMPROVEMENTS ACT OF 1990
S. 2827

SUBMITTED TO THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

JULY 18, 1990

2501 M Street, NW	202-887-1100
Washington, D.C. 20037	Telex 89617 (CMA WSH)

The Chemical Manufacturers Association (CMA) appreciates the opportunity to submit this written testimony on S. 2827, the Federal Deposit Improvements Act of 1990, proposed legislation that would amend the Federal Deposit Insurance Act. CMA is a nonprofit trade association whose member companies represent more than 90 percent of the productive capacity for basic industrial chemicals in the United States. The members of CMA include many companies that are subject to heavy liabilities under Superfund and that therefore have extensive experience in Superfund proceedings.

One effect of S. 2827 would be to exempt the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, other federal banking agencies, insured depository institutions, and other mortgage lenders from potential liabilities under Superfund. CMA appreciates the concern of the sponsors of the legislation that Superfund can operate inequitably to impose liability on parties that do not reasonably appear to be the cause of the conditions found at the various Superfund sites. However, Superfund has led to just this type of inequitable result in many if not most cases, and not just in those cases involving lending institutions. CMA sees no clear or compelling reason to give preferential treatment to lending institutions in contrast to many other groups for which the prospect of Superfund liability is equally -- or even more -- real, threatening, and unreasonable.

Based on our experience in Superfund, we understand the distress caused by the extraordinary imposition of liability under that statute. However, such consequences are normal and routine under Superfund, and this bill addresses only one narrow piece of a much broader problem. To attempt to resolve this small piece of the problem instead of viewing it in a broader perspective and providing a more comprehensive resolution of other similar concerns would be discriminatory and, in our view, unwise.

It is essential to recognize at the outset that the fundamental nature of the liability scheme established by Superfund is <u>severe</u>. The law imposes liability for the cleanup of Superfund sites on owners and operators of disposal sites, former owners and operators, transporters who took wastes to the sites, and generators whose wastes were taken to the sites. That liability is imposed without fault or even knowledge. It is imposed retroactively on actions and practices which were legal, normal, and considered proper at the time. It is imposed irrespective of whether any link of causation exists between the wastes disposed and the conditions at the site requiring remediation. There is no limit to the amount of such liability, and the response costs at Superfund sites commonly run to tens of millions of dollars. Finally, it is imposed as joint and several liability, which means that any of the parties who are liable under Superfund can be held responsible for the total cost.

As inequitable and far-reaching as the Superfund liability scheme may be, the government and the courts have extended its reach even farther to cover a series of cases and situations which stretch the limits of imagination and belief. These include instances where drums of waste from a generator have been sent to a site or facility and subsequently removed intact and sent elsewhere for treatment or disposal (the "transshipment cases"). Another surprising and disturbing example concerns cases where a company has sent raw material to an entirely separate facility of an independent contractor for processing of such material or product and is charged with liability for the cleanup costs at the facility of the independent contractor (the "tolling" cases).

The government has asserted liability against individuals who have served as officers of companies, or even major stockholders, on the basis of their alleged authority to manage or control a company. It has also asserted liability against corporate parents, arguing that Superfund overrides established principles of corporate law and that a corporate parent can be held liable as the owner or operator of its subsidiaries' sites even without following the recognized standards for piercing a corporate veil.

Other inequitable impositions of Superfund liability arise out of applications of the joint and several liability doctrine. A major issue concerns responsibility for wastes

disposed of at a site where the owners and operators of the site are insolvent and the generators and transporters of those wastes cannot be found or are also insolvent -- these wastes are often referred to as the "orphan's share." The government customarily imposes liability for the orphan's share of remedial costs on parties which sent other wastes to the site, refusing to use Superfund moneys to cover such costs even though most of the Superfund revenues are derived from taxes on business. Likewise, the government has often asserted full liability on industrial companies to pay the entire costs of cleaning up a municipal landfill even though they may have been responsible for only a fraction of the total wastes at the site.

Another harsh example of Superfund at work involves the distribution of liability even within the group of industrial PRPs that have clear liability at a site. The government often treats those PRPs in a discriminatory manner, singling out certain companies which may have been most cooperative and thrusting on them predominant responsibility for the site. It can do so by filing suit or issuing an order against a selected minority of the PRPs or by pressuring such a minority to accept a settlement agreement. When it does this the government routinely requires those PRPs to assume all the costs and burdens and leaves to them the task of trying to collect from other PRPs who may be customers or suppliers.

Underlying all of these disturbing examples of the application of Superfund liability is a more fundamental problem: the issue of fairness. A basic feature of the Superfund liability scheme, often noted by courts, is that it pays little or no heed to elementary principles of fairness. That is a mistake. In a government which prides itself on justice, it is difficult to rationalize a program operating on the basis of a blatant rejection of fairness. Moreover, such a liability scheme causes confusion and turmoil in administration of the program, provoking and exacerbating disputes, undermining efficiency, delaying progress, and increasing costs. The phenomenal amounts of transaction costs, especially in comparison with actual cleanup costs, that have plagued the Superfund program since its inception attest to such problems. Neither the Congress nor EPA has developed a coherent framework to implement the overall Superfund liability scheme. A clear need exists to address that challenge, defining the limits of liability in a wide variety of cases and balancing the competing equities affecting the distribution of liability among different perties.

Within the broader perspective of the entire Superfund liability picture, with all its uncertainties and complexities, there is no clear, compelling, or substantiated reason to give preferential treatment to lending institutions. In fact, it does not appear likely that Superfund liability will be imposed

on lending institutions except in a small fraction of unusual cases.

In conclusion, we believe that this legislation focuses upon a significant and troubling example of the extent to which Superfund liabilities have exceeded reasonable limits. However, it is only one example. Many others exist, as described above. If Congress acts to remedy liability problems in Superfund, it should reexamine the full spectrum of situations where such liability has been imposed or asserted. We do not believe that it would be productive, efficient, wise, or fair to undertake this task in a piecemeal fashion. We therefore wish to record our opposition to S. 2827 in its present form.

Chicago Tribune 7/18/90 p10 Sec. 1

# Don't bleed the banks over pollution

Already facing a soft real estate market and greater foreign competition, the nation's banks are now being hit with the tab for cleaning up toxic waste that they didn't create or even knew existed.

Recent court decisions have held lenders liable for costly cleanups on properties they temporarily take over through foreclosure. It doesn't matter whether the bank had a role in managing the property or not.

While it's important to restore areas contaminated by hazardous wastes, it's not fair to slap banks with these enormous bills. In many cases they can amount to several times more than the value of the property. Small-town banks that finance local businesses and farmland are particularly vulnerable. Foreclosing on a few farms that turn out to be polluted by diesel fuel or pesticide leakage could sink them.

Congress, aware of the risks to smaller banks and businesses, is considering legislation that would shield lenders. Banks would be released from any liability beyond the value of the property if they didn't know about the pollution or contribute to its cause. It's a logical position that should be adopted quickly.

When Congress passed the Superfund law in 1980 to clean up the land, it exempted from liability anyone who held a mortgage on the property. In 1986, it added protection for property owners who took reasonable steps to detect possible harzards before buying.

But that same year a Maryland court held a bank liable for more than $550,000 in cleanup costs on a 118-acre farm, valued at $380,000, that it had acquired through foreclosure. The bank said it never knew of any hazard.

Since then, other judges have tapped other banks for environmental funds. In one case, a lender foreclosed on a steel foundry worth about $1.4 million. Environmental officials later accused the foundry of polluting a harbor nearby, and the financial institution now faces a cleanup bill of at least twice that amount.

The court decisions have created a new industry of lawyers and consultants that try to help banks assess their exposure to environmental liability on their loans. Some banks are choosing to write off bad loans rather than foreclose and get socked with a huge cleanup bill. Others are refusing to help borrowers work out of troubled loans when there might be a cleanup problem. Some simply won't lend to high-risk businesses like gasoline stations and dry cleaners.

Banks may not be the only institutions affected. Pension funds, charities and federal agencies are worried that they, too, could end up with polluted properties. The agency in charge of salvaging failed savings and loans, for example, could be on the hook for cleaning up some of the properties it has seized. The proposed legislation would grant federal banking agencies immunity from hazardous-waste cleanup costs.

Some environmental groups and federal bureaucrats oppose the bills because they fear bankers will profit if polluted properties are cleaned and made more valuable at the taxpayers' expense. What they really fear, however, is losing bank resources to help supplement the Superfund cleanup program. The fund itself is financed primarily through taxes on oil and chemicals companies, but the program faces sharp cuts if a deficit-reduction plan isn't agreed to this year. Meantime, opponents of the legislation are content to see credit become more expensive and harder to get.

Banks aren't asking to be let off the hook. They expect to lose loans and property if it's polluted. They are asking not to be charged for something where there is no guilt or negligence. That is only fair.

**Testimony of Fannie Mae**
**Submitted to the Committee on Banking**
**in reference to Senate Bill S.2827**

**July 19, 1990**

Fannie Mae appreciates the opportunity to submit these comments on S. 2827, a bill introduced by Senator Garn to protect depository and other lending institutions and certain federal agencies or instrumentalities, from strict (no-fault) liability under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA or Superfund) and related environmental laws. Fannie Mae supports this legislation and urges extending coverage to Fannie Mae and Freddie Mac.

Fannie Mae is a congressionally chartered, privately owned company whose sole business is to support housing by making a secondary market for residential mortgages. Fannie Mae is both the largest American investor in mortgages, and a major issuer of mortgage-backed securities, secured by properties for low-, moderate- and middle-income families. As of the end of June, 1990, Fannie Mae held about $113 billion in mortgages, and had outstanding approximately $263 billion of mortgage-backed securities (MBS) backed by loans that the company holds as trustee for the owners of such securities. Together, our mortgage purchases and MBS finance about one of every seven mortgages in the United States.

S. 2827 would reduce liability for all primary market mortgage bankers, and all federal insured depositories that acquire real estate through foreclosure and have neither caused the release of hazardous substances, failed to take actions preventing release after receiving actual knowledge of the hazard, or benefited from remedial action. The bill also shelters a smattering of governmental entities from unlimited exposure: all the federal financial institution regulators, the Federal Deposit Insurance Corporation (FDIC), the Resolution Trust Corporation (RTC), and any Federal Home Loan Bank or Federal Reserve Bank that acquires real estate in connection with providing loans or assistance. For both categories, the bill assures that the owner of the property would only be liable for losses up to the pre-clean up value of the property, rather than a total clean-up cost that could far exceed the property's value.

S. 2827 as now structured will complement the comprehensive thrift reform bill (the Financial Institutions Reform, Recovery and Enforcement Act or FIRREA) passed last year in three ways. First, the bill would complement FIRREA's goal of assuring the financial strength of insured institutions going forward, by averting the imposition of potentially crippling clean-up costs on lenders without regard to fault. Second, government-sponsored enterprises (GSEs), such as the Federal Home Loan Banks which Congress chartered to provide thrifts with short and long term loans at affordable rates, would similarly benefit when they foreclose on real estate pledged by thrifts to secure their advances. Third, the bill would reduce the government's exposure as receiver of insolvent thrifts, banks and other insured institutions whose assets include properties subject to potentially large claims for environmental liability.

In each case, providing for limited and quantifiable exposure would allow exempt institutions to act more decisively and efficiently when acquiring properties. The same benefits would accrue to the Federal Deposit Insurance Corporation, or the Resolution Trust Corporation, when taking over failing insured institutions. The bill would free these entities from escalating costs associated with the delays inherent in evaluating the environmental risk of an acquired asset or institution. That is a significant benefit, given the substantial time-related carrying costs that generally characterize acquired properties and failed institutions.

Finally, in the case of healthy private lending institutions, reduced exposure to strict liability would encourage the development of sound, cost-effective environmental assessment procedures that avoid arbitrary restrictions on credit availability based on unquantifiable strict liability risk. There is a further benefit to the public, which would face reduced exposure and delay from burdensome environmental assessments, especially on residential property.

Neither the primary market lenders, nor the government itself, can fully realize these benefits if the bill continues to enforce an artificial distinction between the primary and secondary market.

Over the last decade, the secondary mortgage market has been the premier stabilizing influence in residential finance. As the new risk based capital rules and FIRREA have prompted major rechanneling of mortgage assets and securitization, Fannie Mae's and Freddie Mac's reliable support has been even more vital. Over 80 percent of non-government insured, conforming mortgage loans made to consumers today are financed by Fannie Mae and Freddie Mac.

Given this close interdependence, if S. 2827 simply shifts the potential unanticipated and unquantifiable Superfund costs from primary to secondary market players, Fannie Mae and Freddie Mac will be forced to take defensive actions to limit their risk exposure. Such risk control is imperative to meet Congress' mandate to both companies that each purchase only investment quality mortgages and conduct operations that are "fully self-supporting." Yet these risk reducing measures will have a negative financial impact on the very insured institutions the bill now seeks to aid.

Such actions could well come in the form of: more intrusive and expensive on-site environmental assessments during origination, increased monetary collateral, lower prices paid for loans, more stringent warranties and/or loan buy back provisions, and greater net worth requirements for originators. Any of these measures would reduce the efficiency and raise the cost of mortgage lending, with obvious harmful ramifications for originating lenders, government receivers and the home buying public.

Expanding S. 2827 would avoid such problems and assure that it works for, rather than against, the strong governmental interest in assuring Fannie Mae's and Freddie Mac's continued financial integrity.

Thus, the bill should offer equal protection for equivalent government interests. There are no distinctions between Fannie Mae's exposure and that of the FDIC and depository institutions. When the FDIC takes over failing insured institutions it acquires all assets. These assets could include defaulted home loans which are subject to CERCLA liability. Fannie Mae typically purchases loans in a pool. If a loan goes into default, after there has been an attempt to work out or restructure the loan, Fannie Mae acquires the property through foreclosure. The FDIC and Fannie Mae have an equal interest in avoiding unduly high losses as they deal with foreclosed properties. Under S.2827, the FDIC is exempt while Fannie Mae is liable. This is not logical public policy.

Moreover, a fundamental premise of the bill is that the loan originator (whether an insured institution or a private "mortgage lender"), which investigated the property and underwrote the loan, can be deemed innocent of causing a problem and ignorant of its very existence (necessary conditions under the bill). Clearly, the same conclusion applies in the case of the secondary market GSEs that purchased or guaranteed the loan, usually as one in a large package of loans.

Both Fannie Mae and Freddie Mac are able to supply home credit needs throughout the nation each and every day in all types of economic conditions by using a very streamlined approach. It relies on a combination of delegated underwriting (which makes lenders responsible for originating, underwriting and servicing loans), contractual warranties, and lender monitoring. This permits the type of high volume operation pivotal to the efficient link between home buyers and the capital markets. In Fannie Mae's case, for example, this approach supported an average daily purchase of about 4,200 loans in 1989 (for a volume each business day of about $348 million). Given these realities, there is no logic in exempting from CERCLA liability banks and thrifts that did not know of the environmental problem, while holding liable the GSEs that purchased from those lenders based on the same lack of knowledge.

In summary, we believe S.2827 takes a desirable first step toward protecting innocent lenders, insured institutions and the government from exposure to open-ended environmental liability. However, in limiting the ranks of exempt institutions, the bill in its current form unnecessarily exposes the government to loss and inappropriately distinguishes between primary and secondary market institutions. The changes we have proposed would both strengthen the bill's central purpose - protecting the government - and improve its efficacy and fairness.

Thank you.

THE FARM CREDIT COUNCIL
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Statement by

Peter C. Myers
President & CEO
The Farm Credit Council

before the

The Hon. Donald Riegle, Chairman
Senate Banking Committee

July 19, 1990

Mr. Chairman, my name is Peter C. Myers. I am President and CEO of The Farm Credit Council, the national trade association for the Farm Credit System. The Farm Credit System is comprised of 15 banks, nearly 300 local lending institutions with loans outstanding of about $50 billion to some 650,000 farmers, ranchers and their cooperatives. The Farm Credit System has been serving the credit needs of farmers, ranchers and cooperatives for upwards of 75 years. I am pleased to submit this statement today on behalf of the Farm Credit System.

WASHINGTON FAX: (202) 626-8718
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Mr. Chairman, on April 19th, we wrote to you indicating our desire to work with you to improve S. 2319. We concurred in the need for this legislation because we, too, believe that lending institutions have been unfairly burdened with the costs associated with hazardous waste cleanup. At that time, we expressed our desire to work with you to ensure that the institutions of the Farm Credit System were afforded the same protection as other mortgage lenders. However, we believe the changes included in S. 2827 do not fully address the potential liability of Farm Credit System institutions.

We applaud the revision in your legislation to exempt the regulator of the Farm Credit System, the Farm Credit Administration, from liability. We continue to be concerned however, that absent a specific section exempting banks and associations of the Farm Credit System from liability, it will be fertile ground for a court to once again interpret what it believes Congress intended. To ensure that there is no question, as we believe you intend, we would urge you to consider including institutions of the Farm Credit System in the exemptions along with the Farm Credit Administration, the Farm Credit System Insurance Corporation and the Farm Credit System Assistance Board.

The Farm Credit System by virtue of its Congressional mandate, is expected to provide competitively priced credit and related services in every state. We take this charge to serve agriculture seriously. There can be no question about the inherent risk in lending to agriculture. Fluctuations in price, changes in weather, and the myriad of other problems can lead to financial difficulties for borrowers, as well as for the lender, if there are not adequate safeguards.

We are concerned about court interpretations of current law and enforcement activities by EPA which lean towards extensive liability for lenders under CERCLA. The only guaranteed means we have to deal with this risk is the denial of credit. There can be, as you well know, a tremendous cost associated with environmental cleanup.

We applaud your continued efforts to improve S. 2319 through changes made in S. 2827. We agree with your statement on introduction that there should be protection to Federal banking regulators, insured institutions and lenders from "unnecessary liability arising from their lending or governmental actions."

Lenders are viewed in some quarters as so-called "deep pockets" for funding cleanups. That is not our interpretation, nor do we believe it is the Congress' intent of what CERCLA was to accomplish. We have many specific instances in which institutions of the Farm Credit System sustained significant losses due to delays in foreclosure, not exercising their rights to foreclosure, or simply denied individuals credit due to concern over liability under CERCLA. The following are just a few examples:

- A local Farm Credit Association foreclosed on a fruit farm, which contained a pesticide storage building. Disposal and cleanup costs have exceeded $60,000 to date. Additional costs may exceed $200,000, which the association has set aside, even though they no longer own the property.

- A local association received a loan request from a borrower who wanted a mortgage loan to defray the cost of disposing of several barrels of waste which were found illegally dumped on his property. The association did not make the loan due to potential liability. In past years, we would have made such a loan because it would have been wise to do so, but because of concern over potential liability, the loan was not made.

- During a lengthy foreclosure proceeding on a 188 acre farm local rumors were that the farm's water supply was contaminated. The Farm Credit association was forced to consider whether to walk away from its $170,000 loan or run the risk of being liable for a toxic cleanup where the ultimate cost was unidentifiable. Ultimately, foreclosure occurred, but the delay in action to ascertain what the business risk was.

- A local association made a loan which was secured by a farm. Afterward, a stream running through the property was found to be contaminated with PCBs from a nearby chemical plant. Neither the borrower nor lender was at fault. The borrower then defaulted on the loan, but due to CERCLA liability, foreclosure was not pursued, because the estimated cost of cleaning up the property far exceeded the value of the property. The cost in compromising on the loan totalled $200,000.

These few examples illustrate the very real hazards which exist for System institutions in light of environmental liens and liability concerns. For very obvious reasons, lenders should not be in the position of being environmental police, particularly when their principal function is to provide credit. Such burdens on lenders for monitoring compliance only result in increased interest rates to borrowers--many of whom are small businessmen--or no credit being provided to others where a doubt about liability or uncertainty about contamination exists.

Mr. Chairman, the Farm Credit System does support the fundamental intent of CERCLA to cleanup environmental hazards, but we disagree with the interpretations which have placed a burdensome liability on lenders who have done nothing more than taken title to property over which they had no management control.

At present, many institutions of the System require that an environmental assessment be completed by an independent engineer before a loan is extended. Even minor assessments cost from $1,500 to $3,000 each. More detailed examinations can double or triple that cost if contamination is suspected or even rumored.

As before, we will be pleased to work with your staff in drafting any language necessary to accomplish these changes. For protection of system institutions to be fully consistent with the changes you have proposed in the Federal Deposit Insurance Act, we believe the Farm Credit Act must be amended.

Thank you for the opportunity to have this statement included as part of the record of this important hearing.

THE WRITTEN STATEMENT

OF

THE INDEPENDENT BANKERS ASSOCIATION OF AMERICA

ON

S. 2827 -- THE "FEDERAL DEPOSIT IMPROVEMENTS ACT OF 1990"

BEFORE

THE SENATE BANKING, HOUSING, AND URBAN AFFAIRS COMMITTEE
Washington, D. C.

July 19, 1990

The Independent Bankers Association of America (IBAA) offers the following comments for the hearing record of July 19, 1990 on S. 2827, the "Federal Deposit Improvements Act of 1990". The IBAA is the only national trade association that exclusively represents this nation's community banks.

With one exception, these comments will only address Title I, Subtitle B--Limitation on Liability for Nonculpable Activities which we strongly support. We cannot overlook, however, section 2003--Branching--of Title II This provision would override state branching laws, and would cause us to oppose the passage of the overall bill. We would hope that this controversial provision would be stripped from the bill.

The IBAA has made the limitation of lender liability one of its top pr orities for 1990. At our annual convention in March, the membership adopted a resolution which states, in part, that:

> While the IBAA recognizes the need to preserve our environment, a bank which did not contribute to an environmental hazard created by one of its loan customers should not have to bear the cleanup costs The IBAA supports efforts to amend state and federal "superfund" and other environmental statutes to provide protection from environmental liability for innocent lenders acting only to protect their investments.

In our testimony before the Senate Banking Committee on June 12, 1990 we discussed the unfortunate contribution which the lender liability issue has made to the existence of a credit crunch throughout the nation We stated that recent court decisions have resulted in increasing the costs of applying for, administering, and foreclosing on loans. This has led to higher costs for borrowers, refusals to make certain kinds of loans altogether for certain types of businesses, and refusals to foreclose on certain types of properties This has obvious implications for the small business community which is witnessing the evaporation of many of its lending resources Without a source of money, fewer small businesses will become established or remain in business, and fewer jobs will be available--an unwelcome prospect in a time of economic uncertainty.

In many parts of the country banks have become so sensitized to the possibility of being stuck with cleanup costs that they have virtually cut off all lending to filling stations and convenience stores or other types of businesses with underground storage tanks. This is particularly so throughout Texas Similar findings are coming in from California And bankers in Montana are finding themselves in an unusual dilemma This state of 800 000 people is the fourth largest in territory in the country With its population so spread out, its citizens often travel 200 miles between gas stations, or its farms often install their own. With banks cogni zant of the risks of cleanup costs for problems they did not create, they are tempted to cut off all lending to service stations. Yet

such prudent action under normal circumstances would result in also cutting off a supply of fuel for their vehicles, and thus their entire economy--agriculture, tourism, trade, etc.

This issue is having a dramatic effect not only on the economic development of many communities and states but also on the very survival of some lending nstitutions, and by implication on the safety and soundness of the financial system itself. It is choking off credit to small businesses and costing the nation an untold number of jobs. It is contributing to the existence of an already dangerous credit crunch, and has the potential to make the difference between profitability and failure with many banks With the Federal government and its deposit insurance agencies in control of many of these polluted properties, it also threatens to greatly increase the taxpayers' burden, either by pinning the cleanup costs on the government or by inhibiting its ability to dispose of properties of failed thrifts or banks.

The extent of liability is both unknown and unquantifiable. Properties which have been held for decades have been subject to treatment no onger tolerable under today s standards Records do not reflect the amount of toxics which may have been re eased into the soil during this time, f indeed it is possible to determine the very properties which may require costly cleanups. With every farm in Amer ca a potentia cleanup site and thousands of other properties with the same potential, the contingent liability of both the private sector and the government is astronomical.

Reports have reached the IBAA from bankers in every region of the country. In almost every case, the scenario follows one of two patterns The bank has been approached by a prospective or current customer for a loan. The loans sought are often to establish a service station or a convenience store with gas pumps, or to convert a gas station to some other use although other businesses with chemicals, etc. are involved as well The banks however alert to the possibility of future environmental cleanup costs decide that even with the appropriate certification, the loan is not worth the risk. Millions of dollars and thousands of jobs are lost The other common situation occurs when businesses declare bankruptcy or are unable to meet their loan obligations Banks will often refuse to foreclose if the property may be contaminated.

Within the last two weeks alone we have heard horror stories from 33 bankers in 17 states The properties involved included service stations and convenience stores with underground tanks, an automobile dealership, a hardware store, a railroad yard, a plating plant, an oil production company, a paint and body shop a gas distributor, a well drilling company a handler of hazardous waste, and a farm chemical dealer These small, community banks have turned down nearly $4 million in loans and have refused to foreclose on properties with loans valued at over $2 8 million. This represents only an insignificant fraction of the totality of banks with similar problems across the country. A survey of the nation's 13,000 banks would likely produce frightening results.

While the numbers themselves are instructive, a few concrete examples may more graphically illustrate the extent of the problem. A banker in Arkansas has written that his bank is...

> considered a "problem" institution with an extremely low camel rating We have $3.2 million classified assets in a $20 million loan portfolio. One is a $500,000 loan. In a settlement we received collateral for our $500,000 loan. The collateral is a Jiffy Lube in Chicago that was formerly a gas station. In an effort to clean up this bank, I made a move to foreclose. A small bank in Arkansas has no business with a half a million dollar loan in Chicago.
>
> We began foreclosure proceedings but quickly withdrew when soil contamination was discovered. It will take two years and $200,000 to clean up this contamination.
>
> The loan matured in November 1988 Now I sit with the largest loan in my bank rated substandard, it is past due for a year and a half and can t foreclose because of lender liability The ability to foreclose would greatly improve my loan rating by removing this loan from substandard classification and place it in "Other Real Estate Owned I also have a buyer for the property but can t sell it because I don't own it. Furthermore, the buyer does not want to accept the cleanup costs.

A small bank in Texas reported that it faces the loss of $100,000 from...

> ...a rather large loan on our books secured by property which is in severe default. At this time, we are afraid to foreclose on the property due to the owners previously using this property to park trucks.
>
> After an EPA survey was done, which cost in excess of $2,200, it was discovered that an employee from the trucking business poured approximately one-half barrel of oil on the back portion of this property. Estimated cost to clean this is in excess of $6,000. Both amounts, survey and clean up cost, are extremely high.
>
> Due to the liability that we could incur, we have been delaying foreclosure...

And in Iowa, a small bank informed us that it...

> ...has a delinquent mortgage on a service station that it would have foreclosed two or three years ago if it were not for the possible liability for cleaning up the environment
>
> The owner ceased operating the station more than two years ago. The station has deteriorated in value and has been a detriment to the city and its industrial development. The

bank has been forced to accept a below market interest rate to enable the borrower to meet monthly payments. An offer to purchase the station has been outstanding for six months subject to a current bill of health with regard to possible contamination. The borrower not wanting to incur liability now for cleanup, has been reluctant to get the proper inspections done.

All in all, this has been a very frustrating and costly experience to the bank. If the bank were exempt from liability for cleaning up the property, this matter could have been concluded two years ago.

A banker in Oklahoma has informed us that his situation is compounded by state, as well as Federal environmental law:

> n Oklahoma, one of the most frustrat ng experiences is that three state agencies are involved in the environmental protection cleanup and one of those state agencies is particularly slow and ill prepared to deal with the problem and is causing delays resulting in loss of interest on the salvageable funds that could be obtained if we could go ahead and get a ruling as to when we have completed our requirements.

In Wisconsin, a bank foreclosed on a railroad yard. Sitting in the yard since 1964 was a railroad car which leaked sulfuric acid. After coordinating its efforts with several state agencies and the EPA, the bank paid $80,000 to clean up the site. Even though it had absorbed that expense, however it was informed that because it failed to file a plan for the cleanup that a fine of $25,000 per day could have been levied against it This same banker has turned down about a dozen loans during the past 3 years because the applicants' sewer systems were not up to current standards

And in a final example which illustrates the justification for banker concern, it is worth repeating an exchange between Senator Garn and John Shivers, the IBAA witness at the June 21 credit crunch hearing:

> Senator Garn. ...You indicated the superfund liability was certainly reducing credit availability t certainly has been my experience that even when lenders have been doing due diligence on otherwise very sound loans, they have just felt compelled to walk away from those lending opportunities because they are afraid ..that there might be some environmental problem. I would appreciate it, Mr Shivers, if you would repeat the example you gave me as we were talking about the hearing...
>
> I would like this in the Committee record and my colleagues to hear how ridiculously this has been carried forth in some respects.

> Mr. Shivers. This was told to me, Senator, two years ago by a banker friend...the EPA named his bank in an action over a piece of land, and when they checked the deed history of the land and the old records of the bank, the bank way before his time had foreclosed on this piece of land in 1947. It was on the intercoastal canal. And as near as they could tell from newspaper clippings of the time of the canal, there was nothing but salt marsh there, just grass. And in the intervening time, and they owned it for a three-months' period and sold it, and in the intervening period, no telling how many owners they had and all sorts of developments and businesses were there.
>
> Well, the EPA, that was the only business they could find that ever touched that piece of land that still was in existence so (all) they could find was the bank, and they wanted the bank to pay some ungodly amount of money to clean it up.

The IBAA is grateful to Senator Garn for recognizing the magnitude of this problem. The lender liability provisions of S. 2827 would provide protection to lenders as well as Federal depository agencies from the unjust imposition of cleanup costs for contaminated sites. It would release desperately needed sources of funds for small businesses, help create more jobs, and prevent a further dramatic escalation of the costs of resolving the thrift crisis, while possibly avoiding a similar problem with commercial banks. At the same time, passage of these provisions would retain the essence of the superfund legislation. The IBAA strongly supports the lender liability provisions of this bill and urges its passage this year.

**TESTIMONY OF**

**THE INTERNATIONAL COUNCIL OF SHOPPING CENTERS**

**on**

**Lender Liability**

**and**

**The Lender Liability Act of 1990**

**Presented by**

**WILLIAM H. McCABE, JR.**
**Partner**

**NEW ENGLAND DEVELOPMENT**
**Newton, Massachusetts**

**to**

**THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS**

**of the**

**UNITED STATES SENATE**

**July 19, 1990**

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The International Council of Shopping Centers
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**SUMMARY**

1. The Superfund law which establishes liability for the cleanup of environmental contamination of property can result in enormous liabilities for lenders and property owners, far exceeding the price paid for the property or the amount loaned on the property.

2. Recent judicial decisions have expanded the environmental liability of owners to lenders in ways not foreseen or apparently intended by Congress when Superfund was enacted. Because of this, ICSC supports the enactment of the Lender Liability Act of 1990, S. 2827.

3. There has been uncertainty about what actions are necessary to take advantage of the "innocent landowner" defense to superfund liability because no standards exist for what constitutes an "adequate inquiry" into the potential contamination of a property. Thus, despite the conduct of extensive and expensive examinations of real property prior to transactions, termed "environmental assessments" or "environmental audits " the innocent landowner defense has been invoked to no avail, because of some defect in the assessment.

4. An effort is under way by interested groups to develop a consensus standard for such environmental audits, with the objective of having such standard adopted by EPA as sufficient to qualify for the innocent landowner defense. This Committee should encourage EPA to adopt such a standard when it is developed.

5. While ICSC has been a strong supporter of efforts to improve and maintain the environment as it is impacted by shopping centers, ICSC also has been concerned about the applications of the environmental laws that have overreached or have had a perverse impact on the environment One of the most extreme examples of the negative impact of environmental regulation has been that which has encouraged unnecessary removal of asbestos from buildings where its condition and location would allow it to be managed safely in place. Although EPA has acted to correct this problem, the imposition of such unnecessary environmental costs on real property owners reduces their financial ability to make debt service payments and the value of the property held as security by their lenders. Because of the impact on lenders, the Committee should be concerned about the proper application of the environmental laws.

6. The potential environmental liability of lenders increases their risk in making real estate loans. This is compounding a major problem for shopping center developers that ICSC testified on before the Committee last month -- the credit crunch As we stated banks are unwilling to make loans for economically sound shopping center development, and the reason appears to be excessive risk aversion to real estate lending caused by a number of factors, including environmental risk.

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**Statement of**
**The International Council of Shopping Centers**
**Presented by**
**William H. McCabe, Jr.**
**to**
**The Committee on Banking Housing and Urban Affairs**
**July 19, 1990**

## I. Introduction

### A. The International Council of Shopping Centers

I am William H. McCabe, Jr., a partner in New England Development of Newton, Massachusetts, which develops, owns, and operates shopping centers and mixed-use facilities in several states. Also, I am the Chairman of the Environmental Issues Task Force of the International Council of Shopping Centers (ICSC), and I am presenting this testimony on behalf of ICSC.

ICSC is the trade association of the shopping center industry. The members of ICSC, consisting of shopping center developers, retailers, investors, managers, and others having a professional or business interest in the shopping center industry, are engaged in the day-to-day activities of designing, planning, constructing, managing, financing, developing, leasing, and owning shopping centers and their retail stores. ICSC has approximately 29,000 members and its over 27,000 members located in the United States represent a majority of the over 35,000 shopping centers in this country.

The Government Relations office of ICSC is located at 1199 N. Fairfax Street, Alexandria, Virginia, (703) 549-7404, and ICSC is headquartered at 665 Fifth Avenue, 11th Floor, New York, New York, (212) 421-8181.

### B. The Shopping Center Industry

The shopping center industry is a major contributor to the economic well being of the United States. <u>In 1989, the shopping center industry contributed $676 billion to total retail sales in the United States</u>, an amount representing 55% of all retail sales, excluding automobiles and gasoline purchases. Each month over 90 percent of all Americans over the age of 18 visit a shopping center.

The shopping center industry employs more than <u>9.9 million</u> workers, or 9% of nonagricultural employment in the United States. The dollar value of construction of shopping centers amounted to $7.4 billion, or nearly 7.5% of total nonresidential construction in 1989. When one includes retail sales, the value

of construction, and employment income, the shopping center industry contributed an estimated $784 billion to the 1989 economy. This contribution does not include such things as: the sales taxes generated by the retail trade, the income taxes collected on employment income, the added construction value from renovations, or any multiplier effects. The inclusion of sales taxes paid to states alone involves $26 billion.

C. Relationship to the Credit Crunch

ICSC recently testified before this Committee regarding the "credit crunch" involving commercial bank lending for shopping center construction and other activities As we described in that testimony, ICSC members are having serious and increasing problems in securing financing for economically sound shopping center development and other activities

In that testimony, ICSC explained that one of the potential reasons for the credit crunch is the excessive risk aversion of lenders to making real estate loans arising from a number of reasons, including potential lender liability for environmental cleanup costs.

D. ICSC Position on S. 2827

Recent decisions interpreting the CERCLA exemption from liability for cleaning up hazardous substances for lenders have been so restrictive that they have negated the statutory intent to limit lender liability. In effect, the decisions protect a lender as long as it does not enforce a security interest in a property However it appears that as soon as a lender takes almost any action with respect to protecting its security interest in a secured property, it is at risk of exposing itself to full liability for environmental cleanup costs. If a lender cannot rely on its security in a property without exposing itself to liabilities which may be larger than its loans on the property, then the security becomes worthless and the loan will not be made.

Unless Congress corrects this situation, it will become very difficult for lenders to accept real estate, classically prime security, as good security for a loan. For this reason, we support the Lender Liability Act of 1990, S. 2827, and H.R. 4494, similar legislation in the House.

E. ICSC Position on the Broader Issues of Environmental Risk

Beyond the narrow issue of the impact of environmental risks on real estate lenders, there is a broader issue of the impact of environmental laws and policies that overreach and impose costs that unreasonably devalue real estate, the real estate loan portfolios of lenders, and the financial and economic systems

generally.

Thus, this Committee should be concerned about the impact of environmental regulation on the owners of property.

## II. Background: Liability For Hazardous Substance Cleanups

### A. CERCLA, SARA, And The Innocent Landowner Defense

In the last ten years, the issue of liability for the contamination of property with hazardous substances has become a serious one for real estate owners, lessees, lenders, and others involved in real estate transactions. More recently, the impact of this issue on various Federal programs, including the activities of the Resolution Trust Corporation, has become apparent.

The importance of this issue was greatly enhanced by the enactment of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA" or "Superfund"). Under CERCLA, even parties who had no involvement in the contamination of property with a hazardous substance may be found liable for expense of cleanup. Thus, CERCLA imposes strict liability without negligence and applies it jointly and severally to all "potentially responsible parties" without regard to their actual contribution, if any, to the contamination of the property.

Congress provided an exemption from CERCLA liability for some persons acquiring previously contaminated property by enacting the "innocent landowner defense" in the Superfund Amendments and Reauthorization Act of 1986 (SARA). In general, this defense allows a party to avoid liability for contamination predating his ownership of the property, if he "did not know and had no reason to know" that the property was contaminated at the time of acquisition. To establish that he had "no reason to know" of pre-existing contamination of the property, an acquirer of property must show that he has undertaken "all appropriate inquiry into the previous ownership and uses of the property, consistent with good commercial or customary practice, in an effort to minimize liability."

The specific requirements of this "reasonable inquiry" were not defined in the legislation. The legislative history states that defendants in CERCLA actions will be "held to a higher standard as public awareness of the hazards associated with hazardous substance releases has grown" and that "good commercial or customary practice" means that a "reasonable inquiry has been made in all circumstances, in light of best business and land transfer principles." Thus, those engaged in commercial real property transactions would be held to a higher standard than those engaged in private residential transactions.

The ambiguity of this language has created a situation where the degree of inquiry required by the courts and those involved in the acquisition of real property is constantly expanding and has no fixed scope or limits. Because of the generality and lack of precision of the language, it virtually always can be argued that "all appropriate inquiry" and "good commercial or customary practice" would have dictated that more should have been done, since obviously the property was in fact contaminated when acquired and hindsight is always 20/20.

B. Environmental Assessments

The inquiry necessary to establish the innocent landowner defense now comes under the rubric of "environmental due diligence." Environmental due diligence techniques also are sometimes used as a risk management device by purchasers, tenants, lenders, and others involved in real property transactions. Most real estate purchasers and lenders now demand that an examination of a property, termed an "environmental assessment" or "environmental audit" be done before a loan is made or its ownership or use is transferred.

As now generally practiced, the environmental due diligence process consists of a series of phases:

- Phase I. Documents regarding the history of the property and its compliance with applicable environmental laws (e.g., Clean Air Act, Clean Water Act, etc.) are reviewed. A visual examination of the property is conducted to look for asbestos and evidence of environmental contamination such as chemical spills.

- Phase II. Soil and groundwater are sampled to evaluate the possible presence of contamination. This usually involves the installation of monitoring wells. Subsequent sampling and analysis is often required to further define the nature and extent of the contamination. This phase also may include a "risk characterization" to evaluate human health impacts, the sampling of suspect asbestos material the testing of underground tanks for leaks, radon evaluation, etc.

- Phase III. The methods and costs of undertaking the cleanup of any significant contamination are determined. In addition to considering the use of one or more standard methods of cleanup, it may be necessary to design and test a variety of innovative remedial processes.

The environmental audit process can be very expensive. Since the cost of analyzing a single soil sample can exceed $1600 and that of disposing of a cubic yard of soil can exceed $250,

the costs of a cleanup may easily exceed the value of the property. Cleanups costing in excess of $3,000,000 are not at all unusual.

However, in the end the environmental assessment may be useless in protecting a lender (or property owner) from liability if whatever is done is later determined to be inadequate.

This occurs because there are no accepted standards for environmental assessments, and their scope varies widely depending on the requirements of the particular parties to the transaction. An effort is now under way by the American Society for the Testing of Materials (ASTM) to establish standard procedures for environmental assessments. ICSC and representatives of other real estate groups, lenders, lawyers, and consultants are participants in the ASTM standard making process with the goal of developing a voluntary, consensus standard for establishing the innocent landowner defense that will be adopted in general commerce and accepted by the regulatory agencies and the courts.

This Committee should encourage EPA to adopt such standards when they are developed as one means of making an "adequate inquiry", thereby providing certainty for those seeking the protection of the innocent landowner defense.

III. Recent Judicial Decisions

As the Committee is aware, the combination of undefined statutory language and EPA's extremely vigorous efforts to find someone connected with a property with funds to pay for cleanup costs, especially where the person responsible for the contamination is no longer in business, have produced judicial decisions that have imposed on lenders the problems and costs of environmental cleanups imposed by CERCLA. In the face of these decisions when a borrower defaults on a loan, a lender now may hesitate to act to protect its security interest or to foreclose because EPA may impose on the lender a liability far in excess of the amount of the loan, since environmental clean-up costs have no connection whatever to the amount of the defaulted debt.

Some of the cases raising concern for lenders in this regard may be summarized as follows In 1986, federal district courts ruled in two cases that CERCLA liability would be imposed on lenders when they foreclose on property. U.S. v. Maryland Bank & Trust, 632 F.Supp. 573 (Md. 1986) and Guidice V. BFG Electroplating, 732 F.Supp. 556 (W.D. Pa. 1989).

However until recently, the courts have concluded that so long as a lender did not foreclose on a property and had not participated in the day-to-day operations of the property, the lander would not have any liability for cleaning up the site.

Most recently, the Federal Appeals Court for the Eleventh Circuit ruled that a lender is liable for cleanup costs "by participating in the financial management of a facility to a degree indicating a capacity to influence the corporation's treatment of hazardous wastes." U.S. v. Fleet Factors Corp., 901 F.2d 1550 11th Cir., 1990). Although the court in Fleet Factors correctly rejected EPA's request for a finding of liability for "any secured creditor that participates in any manner in the management of a facility," the court's standard in practice is almost as problematic. The Court held that a lender can be held liable if it participates in the financial management of a facility in which it holds an indicia of ownership "to a degree indicating a capacity to influence the [borrower's] treatment of hazardous waste."

Thus, in a workout situation, when EPA is most likely to proceed against the lender, the lender now has the following choices:

1. protecting its interests in the traditional manner by "participating in the management of a facility to a degree indicating a capacity to influence" the borrower's significant decisions, thus falling afoul of the Fleet Factors test;

2. foreclosing on the property and running the risk of being required to assume the liability of unknown environmental clean up costs because an environmental audit was not done or is declared defective in hindsight; or

3. not foreclosing and severely limiting its participation or not participating at all in the borrowers business decisions, thereby, running the risk that the resources of the business will be dissipated.

Real estate has always been considered prime security for loans, both on the property itself and on businesses associated with it. Now it has become suspect as security. What good is security, if it cannot be realized on without risking substantial, unknown liabilities in excess of the value of the loan?

These decisions are contrary to Congressional intent in enacting CERCLA with an express exemption from liability for a lender that "holds indicia of ownership primarily to protect his security interest ..." Despite this clear legislative language, the courts in their search for deep pockets to pay for hazardous waste cleanups, have undermined the intended protection for lenders in the exercise of their rights to foreclose on and protect their security interests.

IV. Legislation Limiting Lender Liability

ICSC supports The Lender Liability Act of 1990, S. 2827, and H.R. 4494, similar legislation in the House. ICSC believes that this legislation strikes the appropriate balance between encouraging actions that protect the environment and protecting the financial system and businesses from unreasonable economic harm.

The Senate bill protects the environmental and economic interests involved by exempting insured depository institutions and mortgage lenders from liability under CERCLA, and excluding from the exemption lenders who had actual knowledge that a hazardous substance is located on a property or who caused such a release on the property but failed to take all reasonable actions necessary to prevent the release of the substance.

ICSC strongly urges the Committee to pass S. 2827 as soon as possible.

V. Broader Real Estate Environmental Issues of Concern

In addition to the specific requirements for cleanup under CERCLA and the associated costs, there are much broader issues surrounding the environmental aspects of real estate that affect lenders. In general, anything that increases the costs of owning or maintaining real property or reduces its value increases the risks of owning, leasing, or making loans on the property.

While ICSC has been a strong supporter of efforts to improve and maintain the environment as it is impacted by shopping centers, ICSC also has been concerned about the applications of such environmental laws that have overreached or have had a perverse impact on the environment

One of the most extreme examples of the negative impact of environmental regulation has been that which has encouraged unnecessary removal of asbestos from buildings where its condition and location would allow it to be managed safely in place. It has been estimated that it will cost building owners over $100 billion to remove asbestos from their buildings. It has become apparent to everyone, including the EPA and the Congressional committees with jurisdiction over the issue, that the removal of the substantial portion of the asbestos in buildings that can be safely managed in place is not only unnecessary, but would create environmental problems. This unnecessary removal primarily has been caused by a public misconception that all asbestos must be removed from buildings based on overly-alarming statements by EPA and the Congress. This misperception has created market pressures by tenants, lenders, and purchasers of buildings for the unnecessary removal

of all asbestos, whether or not it can be safely managed in place. In recent months, EPA has moved to correct this situation by making statements and issuing guidance documents that indicate that managing asbestos in place, rather than removal, is safe and acceptable in appropriate cases. However, more needs to be done.

In addition, Congress is now considering legislation that would extend certain asbestos related requirements from schools to public and commercial buildings. This legislation could be adopted in a way that would result in even more unnecessary removal of asbestos from buildings. This would further weaken many real estate owners devalue their properties, and increase the risk to their lenders.

Legislation that would create a new program regarding research on indoor air pollution is now awaiting floor action in the Senate and is being considered by committees in the House. If drafted properly, this legislation could provide valuable research on ways to mitigate indoor air quality problems. If drafted in a way that triggers pressures that force building owners to take actions that are environmentally unsound, unnecessary, and expensive, then this legislation would create problems similar to those experienced with asbestos.

Other environmental issues such as wetlands protection also affect the risk involved in real estate loans The denial or substantial delay in approval of wetland permits or requirements and regulations to undertake expensive remedial measures can kill a project and make an existing loan valueless.

The costs of removal of asbestos or of dealing with other indoor air quality problem decrease the cash flow of the property owner and his ability to maintain and modernize the property, to attract and keep tenants, and to make the payments to carry debt. Both environmental problems and the costs of environmental cleanup reduce the value of real property and its value as collateral for a lender.

As discussed below, because of this impact on lenders, this Committee has an interest in and should be concerned about all environmental legislation and regulation that affects property financed with debt.

A. Risks To Lenders, The Deposit Insurance Funds, And The Resolution Trust Corporation Posed By Potential Real Estate Environmental Liability Claims

ICSC believes that the risks for lenders, described below, would also apply to the FDIC and RTC as potential holders of real estate through foreclosure. Any person that holds real property, as an owner-operator, through a foreclosure by a

financial institution, or through a conservatorship by a government agency, is equally at risk from potential environmental liability claims.

B. Risks To Lenders Under Current Environmental Law

There is major hidden exposure of the banking system to the impact of environmental liability. The most serious threat is imposed by loans made on properties years ago before the problems of hazardous waste contamination of real property were understood, and where no environmental assessments were conducted prior to the making of the loan However, even loans made more recently on properties where an environmental assessment conducted by a competent consultant found no evidence of contamination pose a threat to lenders because the contamination may be hidden and the assessment may be declared inadequate to protect against either the borrower's or lender's liability under CERCLA.

We do not have figures quantifying the extent of the exposure of lenders to environmental liability. Each lender's liability will depend on how many properties in its loan portfolio have been contaminated and how expensive it will be to clean it up. Where contamination exists and the cleanup costs are high, loans may not be repaid because of the impact on the borrower of the cost of cleanup, and the value of the property may be reduced below the value of the balance of the loan by the costs of cleanup.

We note that in a Forbes Magazine article published earlier this year, a senior manager for KPMG Peat Marwick who specializes in environmental financial management estimated that banks could be responsible for $100 billion in environmental cleanup costs over the next 50 years.

As described above, the risks of environmental liability that have already been identified by financial institutions may be the tip of the iceberg of the total risk to the financial system from the application of the environmental laws.

C. Response Of Lenders To The Risks That Arise Under Current Environmental Law

Because of the threat of environmental liability, virtually all real estate loans now at least are partially recourse Non-recourse loans have been important to real estate development because persons whose business is the development and operation of rental real estate properties generally operate through partnerships and recourse loans are reflected on their personal balance sheets as potential liabilities Thus, if loans were recourse, developers with even a small number of properties would have such large liabilities on their personal balance sheets as

to preclude any future lending by most lenders. This would limit the development of real estate by the most experienced, efficient, and successful developers and owners.

Now, because of the real estate environmental liability problems of lenders, developers are receiving loans that are recourse as to environmental problems. Because of the potentially large cleanup costs involved, such loans may be equivalent to, if not more extensive in liability than, full recourse on the amount of the loan.

Thus, the environmental problems of real estate further exacerbate the credit crunch problem about which ICSC testified before the Committee last month. At same time as the banks are becoming more risk adverse to real estate loans, the environmental regulators are increasing the risks of lending for real estate.

D. Risks Of Loss To Agencies Or Instrumentalities Of The Federal Government Arising From Risks To Lenders Under Current Environmental Law And Lenders' Responses To Those Risks

The federal agencies and instrumentalities that may have to foreclose on real property are likely to have the same problems for lenders regarding environmental liability as described above.

V. Conclusion

ICSC strongly urges the Committee to examine not only the specific problem of the environmental liability of lenders under CERCLA, but also the broader problems of how the application of the environmental laws, including EPA enforcement policies and judicial decisions, are imposing hidden risks on the financial system. ICSC urges the Committee to be concerned about all environmental legislation that affects the value of security of financial institutions.

Also, ICSC urges the Committee to examine how the responses of lenders and the bank regulatory system regarding the environmental liability involved in real estate loans are combining to exacerbate the credit crunch for shopping centers and other businesses that own real estate.

Further, ICSC urges the Committee to approve S. 2827 as soon as possible.

# DONEY, CROWLEY & SHONTZ

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Mr. Ed Malan
Senate Banking Comm.
Rm 534
DSOB

Ed,

Per our telephone conversation, enclosed are six copies of written comments in re S 2827 for the record of tomorrow's hearing (7-19-90).

Our staff contact in this matter is Ruth Ambers.

Sincerely,

John Shontz

Specializing in water, natural resource & environmental law (including hazardous substances), and government relations

*Also admitted in Maine & Massachusetts **Also admitted in the District of Columbia ***Also admitted in California (inactive)

COMMENTS

FOR THE RECORD

BEFORE THE BANKING COMMITTEE OF THE UNITED STATES SENATE

IN RE S. 2827

Presented by

JOHN T. JOHNSON, President and C.E.O.

Miners Bank of Butte
Butte, Montana

July 19, 1990

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE.

I AM JOHN T. JOHNSON FROM BUTTE, MONTANA. I AM PRESIDENT OF MINERS BANK OF BUTTE. OUR BANK IS A FINANCIALLY SOUND, SMALL, RURAL BANK. THE BANK'S TOTAL RESTRICTED AND UNRESTRICTED CAPITAL IS $2,500,000.00.

IN 1980, PRIOR TO THE ENACTMENT OF CERCLA, OUR BANK EXTENDED A $200,000.00 SBA GUARANTEED TERM LOAN TO MONTANA POST AND POLE, A TELEPHONE POLE TREATMENT COMPANY IN BUTTE, MONTANA. DUE TO CHANGES IN FEDERAL LOGGING REGULATIONS, MONTANA POST AND POLE WAS UNABLE TO REMAIN IN BUSINESS. THE COMPANY DEFAULTED ON ITS LOAN TO THE SBA AND TO MINERS BANK IN EARLY 1984.

IN JUNE OF 1984, WITH THE ASSISTANCE OF THE SMALL BUSINESS ADMINISTRATION AND WITH THE VOLUNTARY CONCURRENCE OF THE OWNERS OF MONTANA POST AND POLE, MINERS BANK FORECLOSED ON CHATTELS AND RECEIVED A DEED IN LIEU OF FORECLOSURE ON A PORTION OF THE PLANT SITE OWNED BY MONTANA POST AND POLE. THE BANK SUBSEQUENTLY WROTE OFF THE DEBT. AFTER THE BANK WROTE OFF THE DEBT, THE BANK NO LONGER HAD VALID SECURITY INTEREST IN THE REAL PROPERTY; WITH THE ACQUIESCENCE OF THE SBA, MINERS BANK RETURNED THE DEED TO THE OWNERS OF MONTANA POST AND POLE IN SEPTEMBER OF 1984. THE BANK ALSO RELEASED ALL OTHER CLAIMS TO THE REAL PROPERTY THAT SEPTEMBER. THE DEED FROM MONTANA POST AND POLE TO THE BANK WAS NEVER RECORDED AND, AS A RESULT, MINERS BANK PROPERLY CONTENDS THAT TITLE TO THE PROPERTY NEVER ACTUALLY TRANSFERRED TO THE BANK.

EVEN SO, AND ON THE BASIS OF THE BANK'S ALLEGED AND DOUBTFUL THREE MONTH OWNERSHIP OF A PORTION OF THE PLANT SITE IN 1984, THIS PAST FEBRUARY, SOME SIX YEARS LATER, OUR BANK WAS ONE OF THREE PARTIES NAMED AS A P.R.P. (POTENTIALLY RESPONSIBLE PARTY) BY THE E.P.A. AND THE STATE OF MONTANA ON THE MONTANA POST AND POLE SITE. THE OWNERS OF MONTANA POST AND POLE ARE VIRTUALLY JUDGMENT PROOF. THE REMAINING PARTY IS ONE OF AMERICA'S LARGEST CORPORATIONS; ARCO. WE BELIEVE THAT THE STATE AND E.P.A. EXPECT MINERS BANK TO PAY A SUBSTANTIAL PORTION (IF NOT HALF) OF THE TOTAL COSTS OF CLEANING UP THE MONTANA POST AND POLE SITE.

THE PRE-CLEANUP COSTS ON THE SITE ARE PROJECTED AT $1,200,000.00. THE ACTUAL CLEANUP COSTS AT THE SITE ARE PROJECTED TO BE ABOUT $8,750,000.00. THE TOTAL BILL FOR THE CLEANUP WILL THEREFORE BE ABOUT TEN MILLION DOLLARS. IF MINERS BANK IS FORCED TO PAY ONE HALF OF THE COSTS OF JUST THE PRE-CLEANUP COSTS AT THE SITE, OR $600,000.00, THE BANK'S CAPITAL WILL, TO USE A BANKING TERM OF ART, BE UNDER <u>CLOSE</u> <u>REGULATORY</u> <u>SCRUTINY</u>. IF THE BANK IS FORCED TO PAY AS MUCH AS $1,500,000.00 IN THIS PROCESS, THE BANK

COULD BE JUDGED INSOLVENT BY THE REGULATORS. THE BANK SIMPLY DOES NOT HAVE THE RESOURCES TO PAY EVEN A SUBSTANTIAL PORTION OF THE CLEAN UP COSTS. AS I STATED OUR TOTAL RESTRICTED AND UNRESTRICTED CAPITAL IS ONLY $2,500,000.00.

IN 1984, OUR BANK USED ENVIRONMENTALLY ACCEPTABLE LOAN MANAGEMENT PRACTICES. FOR EXAMPLE, THE DESCRIPTION ON THE DEED GIVEN TO THE BANK WAS FOR A PORTION OF THE SITE THAT WE BELIEVED WAS NOT CONTAMINATED. WE WORKED CLOSELY WITH THE SBA AND UNDER ITS DIRECTION IN HANDLING THIS PROBLEM SBA LOAN. WE ATTEMPTED TO ACT AS, IF NOT MORE, PRUDENTLY THAN BANKING AND CORPORATE LAW REQUIRES. THE SOUND MANAGEMENT PRACTICES THAT WERE ACCEPTABLE SIX YEARS AGO NOW, HOWEVER, APPEAR TO BE A POTENTIAL DEATH KNELL.

I ALSO WANT YOU TO KNOW THAT AS A P.R.P., OUR SMALL BANK HAS PAID OUT OVER $120,000.00 IN TECHNICAL SUPPORT AND LEGAL EXPENSES SINCE FEBRUARY 1 TO DEFEND ITSELF IN THIS MATTER. I AM TOLD THAT A MERE P.R.P. DESIGNATION IS NOT SUBJECT TO ANY DUE PROCESS CHALLENGE; YET THE PENALTIES FOR IGNORING A P.R.P. LETTER ARE POTENTIALLY DEVASTATING. OF COURSE, INSURANCE COMPANIES DISCLAIM ALL RESPONSIBILITY TO DEFEND AGAINST AND TO PAY CLAIMS STEMMING FROM A P.R.P. NOTICE.

I ASK YOU THIS QUESTION: IS IT THE INTENT OF CONGRESS TO BANKRUPT INNOCENT SMALL LENDERS IN THE NAME OF CLEANING UP A WASTE SITE WHEN THOSE INNOCENT LENDERS HAD NOTHING TO DO WITH POLLUTING THE SITE AND THE BANKRUPTCY WILL CONTRIBUTE LITTLE OR NOTHING TO CLEANUP PROCESS?

WE SUPPORT THE THRUST OF SUBTITLE B, S. 2827. THANK YOU.

**MORTGAGE BANKERS**
**ASSOCIATION OF AMERICA**

Michael J. Ferrell
Senior Staff Vice President
& Legislative Counsel

Tel. (202) 861-6509
Fax (202) 452-8785

August 9, 1990

The Honorable Donald W. Riegle
Chairman
Committee on Banking, Housing, and Urban Affairs
Washington, D.C. 20510

Dear Mr. Chairman:

The Mortgage Bankers Association of America respectfully requests that the attached statement regarding S 2827 "the Federal Deposit Amendments Act" be included in the record of the July 19th hearing on this issue. The members of the Mortgage Bankers Association are particularly interested in "Subtitle B" of that bill, the "Lender Liability Act of 1990."

MBA supports a national commitment to protecting the environment and the public health from the deleterious effects of pollution and hazardous substance contamination. The effort to clean up existing contamination and to prevent future contamination is an important public goal of society.

Nevertheless, MBA strongly supports S 2827 because it addresses the issue of the secured creditor exemption for lenders contained in the original 1980 Comprehensive Environmental Response, Compensation and Liability Act of 1980. Recent court decisions which hold lenders protecting security liens liable for cleanup of hazardous waste under the Federal Superfund statute threaten the financial viability of all lenders.

We appreciate the Committee's effort to hold this hearing and examine this serious issue. We look forward to working with the Committee to enact legislation to address this issue this year. Please contact Ann vom Eigen of my staff if you have any questions or we can be of further assistance.

Sincerely,

Mike Ferrell
Michael J. Ferrell

MJF:AvE:lm
Attachment

1125 Fifteenth Street, N.W.
Washington, D.C. 20005-2766

1125 Fifteenth Street, N.W.
Washington, D.C. 20005

Mortgage Bankers Association of America

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**STATEMENT OF**

**THE MORTGAGE BANKERS ASSOCIATION OF AMERICA**

**before the**

**COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
of the**

**UNITED STATES SENATE**

**Hearings on**

**S 2827, the "Federal Deposit Improvements Act of 1990," and Other Environmental Risks to Lenders**

**July 19, 1990**

The Mortgage Bankers Association of America (MBA)* appreciates the opportunity to present its views on S 2827, the "Federal Deposit Improvements Act of 1990", and other Environmental Risks to Lenders. Real estate lenders are profoundly concerned about potential liability under the Comprehensive Environmental Response, Liability, and Compensation Act. ("CERCLA," commonly known as "Superfund"). In consequence, we are deeply interested in Subtitle B of S 2827, the "Lender Liability Act of 1990." Our statement therefor reviews the general issue of lender liability under Superfund, EPA's current policies and practices regarding lender liability, and comments on S 2827.

MBA supports a national commitment to protecting the environment and the public health from the deleterious effects of pollution and hazardous substance contamination. The effort to clean up existing contamination and to prevent future contamination is an important public goal of society. MBA strongly supports S 2827, and similar legislation, such as the House companion legislation, HR 4494, which would restore the exemption from liability for Superfund cleanup for those lenders who do not actually contribute to contamination of a property.

We believe that this exemption was originally intended by Congress, and is necessary because of the practical reality of the business world. Much of the real property, and most businesses in the United States, are financed and, therefore, have outstanding liens. We believe that Congress could not have intended to hold lenders in the business of financing real estate acquisitions liable for hazardous waste cleanup under Superfund because these lenders took action to protect their secured real estate interest.

In contrast, court decisions such as that in U.S. v. Fleet Factors Corp., Case No. 89-8094, slip op. (11th Circ. May 23, 1990), which hold lenders liable for Superfund cleanup if they exercise legal rights under a security lien to restructure a loan or foreclose on a property, could threaten the financial viability of all lenders. If current legal trends continue, lenders could become liable for the cost of cleaning up many "orphan" Superfund sites where financially viable owners or contributors to the pollution at the Superfund property cannot be found. Lenders are being held liable despite the fact that they did not contribute to the

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* The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of housing and other real estate finance. MBA's membership comprises mortgage originators and servicers, as well as investors, and a wide variety of mortgage industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, selling, and servicing real estate investment portfolios. Members of MBA include:

- Mortgage Banking Companies
- Commercial Banks
- Savings and Loan Associations
- Mortgage Insurance Companies
- Life Insurance Companies
- Mortgage Brokers
- Title Companies
- State Housing Agencies
- Investment Banks
- Real Estate Investment Trusts

MBA headquarters is located at 1125 15th Street, N.W., Washington, DC 20005; Telephone (202) 861-6500.

pollution and were not aware of the pollution. In some instances, lenders had exercised due diligence procedures to ascertain whether environmental problems existed prior to extending financing. Lenders are being held liable for cleanup merely because they became owners of the property through default.

In U.S. v. Fleet Factors Corp., the court denied summary judgment to a lender seeking relief from Superfund liability. The decision also encourages lenders to "monitor the hazardous waste treatment systems and policies of their debtors and insists upon compliance with acceptable treatment standards". Lenders cannot, as a practical matter, meet divergent legal requirements to stay at arms length to avoid Superfund liability, while simultaneously policing the environmental practices of their borrowers.

Consequently, we deeply appreciate the Committee's decision to hold this hearing at the present time and focus public and Congressional attention on this issue. MBA believes legislative action restoring the exclusion for lenders is urgently needed for two reasons. Legislation is necessary (1) to provide guidance to the courts, and (2) to discourage parties who see lenders as convenient deep pockets from bringing law suits against lenders who do not cause or contribute to contamination. Enactment of legislation restoring the liability exclusion for lenders is, therefore, a critical goal for mortgage bankers and other lenders. We hope the Committee will proceed to mark up a lender liability bill this year.

Superfund Liability

Superfund provides a statutory framework of strict, joint and several liability to allow recovery for the cost of (1) removing hazardous waste found on a property, (2) remedying a "release or threatened release of hazardous substances," and (3) remedying the harm to natural resources caused by the release. A Superfund release has been very broadly interpreted, to mean almost any type of discharge that violates Federal environmental standards. Under the concept of strict liability, a plaintiff does not need to prove fault. (Neither care, negligence, good or bad faith, or knowledge or ignorance will save a defendant.) In addition, because Superfund liability is joint and several, one person can be liable for the entire cleanup of a property, even if others contributed to the pollution.

Numerous cases have held lenders liable as "owners" or "operators" under the Superfund statute. Sections 9601(a)(1)and (2) define an "owner or operator", in the case of a[a property] facility, as a person "owning or operating such facility, and persons who owned or operated the facility at the time of the disposal of a hazardous substance." Courts have thus held that lenders can be deemed liable as owners of a property in the following situations: (1) as a result of an equity interest in the property, (2) because they have obtained ownership through a bankruptcy or foreclosure, or (3) where they have not foreclosed, but were construed to have contributed to or have operated a facility or site.

The Superfund statute provides two specific forms of relief for lenders who are sued. One provision is a statutory exclusion, the other is a defense. We emphasize that these two statutory provisions are distinct and separate. The secured creditor or lender exemption is clearly designed to accommodate lenders' business practices; the innocent landowner provision is a defense.

<u>The Statutory Exclusion: Secured Creditor</u>

MBA believes recent court decisions have ignored the "existing secured creditor exemption" in the Superfund statute. That exemption was established in the original legislation, which was enacted in 1980. The statute excludes from liability secured creditors, i.e., a person who "without participating in the management of a...facility, holds indicia of ownership primarily to protect his or her security interest in the facility" (42 U.S.C. Sec. 9601 (20)(a)). The court decisions in question fail to recognize that lenders must take actions to protect their security interests. A security lien on collateral which cannot be acted on, is valueless.

<u>The Statutory Defense: Innocent Landowner</u>

A defense to Superfund liability which is available to lenders and other parties is a "third party innocent landowner" defense established under 42 U.S. C. Sec. 9607 (b). That defense precludes liability if environmental damages are caused solely by an Act of God, an act of war, or an act or omission of a third party. The third party must be ... "someone whose act or omission occurs in connection with a contractual relationship."

The Superfund Amendments and Reauthorization Act of 1986 (commonly referred to as SARA), clarified in 42 U.S.C. 9601(35)(A) that "land contracts, deeds or other instruments transferring title or possession" are within the definition of "contractual relationships". SARA also established the innocent landowner defense, which modifies the third party defense. The defense would apply if the real property ... "was acquired by the defendant after the disposal or placement of the hazardous substance..., and the defendant established by a preponderance of the evidence that ... at the time the defendant acquired the facility the defendant did not know and had no reason to know that any hazardous substance which is the subject of the release or threatened release was disposed of on, in, or at the facility."

The defendant must also establish that "(a) he exercised due care with respect to the hazardous substance concerned, taking into consideration the characteristics of such hazardous substance, in light of all relevant facts and circumstances, and (b) he took precautions against foreseeable acts or omissions of any such third party and the consequences that could foreseeable result from such acts or omissions."

To establish that the defendant had no reason to know about the contamination, the statute stipulates "the defendant must have undertaken, at the time of acquisition, all appropriate inquiry into the previous ownership and use of the property consistent with good commercial or customary practice in an effort to minimize liability. For purposes of the preceding sentence, the court shall take into account any specialized knowledge or experience on the part of the defendant, the relationship of the purchase price to the value of the property, if uncontaminated, commonly known or reasonably ascertainable information about the property, the obviousness of the presence or like presence of contamination at the property, and the ability to detect such contamination by appropriate inspection."

There is presently no clear guidance on what actions constitute due diligence to qualify a lender (or anyone else who acquires an interest in property) for this defense. The Environmental Protection Agency (EPA) released a guidance document last year regarding due diligence requirements under Superfund ("Guidance on Landowner Liability under Section 107(a)(1) of CERCLA, De Minimis Settlements under Section 122(g)(1)(B) or CERCLA, and Settlements with Prospective Purchasers of Contaminated Property" June 6, 1989). However, this Guidance does not address the requirements of what specific steps should be covered in an environmental assessment, a tool commonly used by many lenders. Instead, the "Guidance" indicates that "a determination as to what constitutes "all appropriate inquiry" (the level of review) under... the circumstances is to be made on a case-by-case basis." This EPA guidance thus provides no useful information to lenders regarding the appropriate steps for due diligence.

Further, even if EPA provided guidance to Federal agencies or lenders, it will not solve lenders' legal problems as private parties may still bring suit under Superfund, (under 42 U.S.C Sec. 9607.)

We also note that, a 1986 amendment to the CERCLA statute (42 U.S.C. 9601(a)(1)and (2)) provides an exclusion from the definition of owners' for state or local governments who acquire a facility through the types of circumstances with which lenders are concerned, namely bankruptcy, foreclosure, and delinquency. Thus, Congress has, in a prior instance addressed the problem encountered by innocent parties faced with liability under Superfund because a true owner or operator of a property is no longer financially viable.

RISK OF SUPERFUND LIABILITY IN REAL ESTATE TRANSACTIONS

MBA's membership is concerned primarily with secured real estate lending issues, and not with lending practices to ongoing commercial businesses. While a large number of the court cases that have caused lenders concern deal with commercial issues, Superfund liability extends to and arises in ordinary commercial and residential real estate lending transactions. We hope the background information provided below on our membership and how our members address the issue of Superfund liability will prove helpful to the Committee.

Real estate lenders manage their portfolios in a variety of ways. Portfolio lenders primarily originate and hold loans. Traditional mortgage bankers originate loans and quickly place them with investors in the secondary market. Other mortgage bankers do not even close loans in their own name, but match real estate investments and investors, and close a loan in the investor's name. Some lenders also take participatory interests in real estate, particularly in commercial projects, and consequently are technically considered both an owner and a lender.

A significant number of lenders engage primarily in single-family lending. Others specialize in lending for multifamily housing. In addition, commercial real estate lenders, which

include many insurance companies and pension funds, finance nonresidential commercial properties, such as office buildings and hotels.

The possibility of finding hazardous waste sites on properties, and potential Superfund liability, affects all these different types of lenders in all of these different types of transactions.

Owners of property on which hazardous waste is found face the practical problem of disposing of the contaminated material. In addition, property owners may be responsible under nuisance theory in tort law for hazards maintained on their properties. However, the imposition of Superfund's strict, joint and several liability by courts on lenders who had no responsibility for generating, transporting, or disposing of that hazardous waste is yielding highly inequitable results.

While there is obviously a relatively higher risk associated with lending to certain types of businesses, such as chemical manufacturers or waste disposal facilities, the risk of Superfund liability extends far beyond environmentally sensitive operations. Superfund sites include abandoned hazardous waste sites or prior uses which include underground storage tanks. Consequently, the potential for Superfund liability exists even in exclusively residential areas.

If contamination is discovered in a property serving as collateral for a loan, the borrower may encounter unanticipated cleanup costs. Those costs are likely to be significant enough to impact the cash flow from a property and force a borrower to default on its loan. Under existing court interpretations of Superfund, a lender is faced with a Hobson's choice. The lender must either write off the investment in the property, or risk liability for the entire cleanup cost by becoming involved in a workout. The cleanup cost may well exceed the lender's investment in the property, and the value of the property.

Today, lenders who take a partial ownership interest in a property recognize that they may be held liable under Superfund. However, even lenders who do not hold ownership interests, but hold security interests on real estate can become "owners," when a borrower defaults on a mortgage. If a lender forecloses, or is given title to the property in lieu of foreclosure, there is a strong possibility, under current case law, that the lender may be deemed to be actively involved in managing the property, and thus liable under Superfund. In addition, under the Fleet case, lenders who do not take title to real property, but merely take ordinary actions to protect their security interests prior to foreclosure may also be held liable.

These legal theories have formed the basis of lawsuits against lenders. The likelihood of success on these theories, the knowledge that rules of civil procedure encourage joining all potentially liable parties at the beginning of a lawsuit, and the fact that lenders are perceived as "deep pockets" have substantially increased the likelihood that innocent lenders will be involved in litigation. The high cost and lengthy time involved in disproving liability often drive lenders to seek pretrial settlement--a cost effective but not necessarily fair, option for lenders.

## OTHER ISSUES

The remainder of our statement focuses on legal developments relating to lender liability: some early court decisions; the implications of the recent court decision U.S. v Fleet Factor's Corp., and our involvement in a process designed to formulate guidance on the steps involved in environmental due diligence. The statement also addresses some additional technical issues concerning the language contained in S 2827 that reflect recent legal developments, and additional concerns that have arisen as the extent of the environmental liability question has become better understood.

The viability of the secured creditor exemption was first called into question in U.S. v. Maryland Bank and Trust, 623 F.Supp. 573 (D.Md. 1986). The court in Maryland Bank and Trust determined that a bank, which had foreclosed on a loan in default, was liable because it had become an owner of the property, notwithstanding the secured creditor exemption. In contrast, in U.S. v. Mirabile, 15 Envtl.Rep. (Envt L. Inst.)E.D. Pa. 1985, 20992, the court held that ownership resulting from foreclosure was not sufficient to hold a lender liable, but a lender could be liable as an operator if it participated sufficiently in the management of the property. The Mirabile court granted summary judgment to a lender who had secured the property from vandalism, inquired about the cost of removing some drums, and sought additional purchasers. However, in the same case the court denied summary judgment to a lender who participated more actively in the business operations.

These cases are illustrative of the differences among the courts. Further, the dicta in the various decisions provide little direction to lenders faced with the practical reality of dealing with a loan that is in default. The Fleet decision, in addition, may in fact, encourage private parties to sue lenders.

### The Impact of the Fleet Factors Case

As noted above, Congress included the secured creditor exemption in the original Superfund statute when it was enacted in 1980 in order to relieve lenders, who had not caused or contributed to contamination, from liability. However, the courts have interpreted this provision aggressively, and have sometimes held lenders liable for environmental cleanup under Superfund. While previous cases held lenders who became actively involved in business operations liable for Superfund cleanup, the court held that Fleet Factors, a lender, could be held liable as one who participated in the financial management of a facility from which EPA had removed hazardous substances and asbestos containing materials. (emphasis added)

In Fleet, the court effectively articulated a new standard for lenders in stating that "a secured creditor may incur ... liability, without being an operator, by participating in the financial management of a facility to a degree indicating a capacity to influence the corporation's treatment of hazardous wastes. The court stated "that it would not be necessary for the secured creditor actually to involve itself in the day-to-day operations of the facility in order to be liable," although such conduct will certainly lead to the loss of the protection of the statutory exemption. Similarly, the court stated that it would not be necessary for the secured creditor to participate in management decisions relating to

hazardous waste in order to be held liable. Rather, a secured creditor will be judged liable if its involvement with the management of the facility is "sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it so chose." (emphasis added). The court dramatically lowered the threshold of participation in a borrower's affairs that may safely be exercised by a lender. Thus, a lender's most protective option is not to participate at all in any decisions--financial or operational--if it wants to avoid liability.

Prior to this case, lenders could argue the applicability of the precedent set in Mirabile. Under Mirabile, a lender could, without fear of liability, take certain actions to protect its security interest provided that the actions related to financial management, although participation in day-to-day operations of a facility would trigger liability. The Mirabile decision stated that "[M]ere financial ability to control waste disposal practices ... is not ... sufficient for imposition of liability." The Fleet decision thus specifically rejects the Mirabile holding.

In the wake of Fleet, it is not clear what actions lenders may take without fear of incurring liability.

Prior to the Fleet decision, lenders were confident that simply holding security liens collateralized by real property or a security interest in property which was current, would not subject them to Superfund liability. This threat never materialized unless a borrower fell into arrears, i.e., was not current on loan payments. Lenders monitoring loans in their portfolio that were experiencing financial problems could contract for an environmental assessment, and determine, on the basis of that assessment (and other factors), whether foreclosure was an appropriate response. MBA members have in fact, on the basis of such assessments, chosen not to foreclose, and forfeited their investment in a property, rather than subject themselves to potential environmental liability.

Prior to the Fleet decision, lenders could attempt to avoid liability for environmental problems they did not cause. In practice, lenders use the remedy of foreclosure reluctantly, preferring to try to work with defaulting borrowers to cure the defaults and avoid foreclosure. Lenders refer to this activity as a "workout." Loan documents routinely give lenders many powers in workout situations and these powers are routinely exercised, with, of course, the limitation that lenders should not engage in wrongful "control" of a debtor, based on cases such as State National Bank of El Paso v. Farah Manufacturing Company, Inc. 678 S.W. 2d 661 (Tex Civ. App. 1984) (writ dismissed.) Following Fleet, lenders may find that any actions undertaken to "work out" a loan may subject them to liability.

Thus, it appears that lenders will be greatly restricted in terms of the decision they can make regarding loans in default, i.e., in "workout" situations.

It is in the public interest to encourage, rather than discourage, lenders to help borrowers with contaminated property to solve their problems constructively, including cleaning up the contamination on their properties. Unless the secured creditor exemption is interpreted to protect lenders from liability in workout situations, lenders will be discouraged from facilitating this public interest.

The Fleet decision reaches far beyond a reasonable interpretation of the statute and the practical realities of lending practices. This new test effectively turns lenders into environmental policemen. It could easily be interpreted by the court on remand, or by other courts, to require a lender to investigate the waste treatment system and policies of potential debtors. MBA contends that this role cannot feasibly be performed by lenders, who have little or no expertise in the environmental area, and could easily subject a lender to the charge by the debtor of wrongful control.

Environmental Due Diligence

Concerns have been raised that restoring the Superfund exemption from liability for lenders will provide disincentives to lenders to identify environmental hazards on real property and, thus, discourage identification and cleanup of Superfund sites. This perspective fails to reflect economic reality.

As noted above, the presence of environmental hazards dramatically affects the value of the property that serves as collateral for the loans and the ability of borrowers to pay.

Thus, even if S 2827 is enacted, lenders will avoid originating loans on contaminated property. If the borrower is forced into default by cleanup costs and the lender forecloses, the lender is unlikely to find a buyer for the property. Instead, the lender will have a contaminated property in its portfolio. Consequently, even with enactment of S 2827, or similar legislation, pressure to identify environmental hazards will remain.

Many lenders take steps to minimize the probability of environmental litigation by requiring due diligence inquiries before a foreclosure is filed. Environmental analysts or consulting firms can be hired to perform environmental assessments--a review of the property for environmental hazards--as a prerequisite for foreclosing on a loan. This preliminary review often can reduce but not eliminate the risk of environmental contamination on a site.

While the trend to require environmental assessments in connection with originating commercial real estate loans is growing, it is not yet universal. According to a national survey conducted in the fall of 1989 on behalf of Boelter Associates, an environmental consulting firm located in Chicago, an environmental assessment was performed for slightly over seventy percent of recent commercial and industrial real estate loan transactions.

Lenders involved in single family residential transactions typically do not require environmental assessments because environmental hazards not as likely to be present in residential areas, and the cost burden on single family borrowers would be too high.

In addition to providing information on the site, an environmental assessment may also qualify a lender for exclusion from Superfund liability under the "innocent landowner" defense added to the Superfund statute discussed above.

Superfund liability is thus significantly changing the way in which commercial real estate lenders do business, and, in the process, is increasing real estate transaction costs. The

costs associated with environmental investigations and the delays involved in conducting analyses can also place the economics of a real estate transaction at risk. Lenders see that although they had no involvement in generating or depositing hazardous waste on a property, they may be liable for a remedial action several times the value of the property. In many instances, the cost of cleanup can far exceed the value of the land that is security for the loan.

While environmental assessments can prove valuable in identifying environmental hazards, they are expensive and not infallible. Most often, environmental assessments are conducted in phases with subsequent, more intensive assessment occurring only if deemed necessary by results of the phase one assessment. The cost of environmental assessments can run from a low of approximately $2,000 to many tens of thousands of dollars. Although the absence or presence of contamination is not tied to the value of the transaction, for practical purposes a small transaction cannot bear the same costs as a large transaction. A loan on a $60,000 residential property, or even a loan on a $750,000 garden apartment buildings cannot bear the same assessment costs as a loan on a multi-million dollar office building. Moreover, even when the value of the transaction justifies greater expense, there will always be unknown risks. Consequently, we are concerned that the term "appropriate inquiry" in the innocent landowner defense provided by Congress in SARA should not be interpreted so as to impose unrealistic standards of inquiry on property owners and lenders.

There is little useful judicial or regulatory guidance as to the meaning of the inquiry required to qualify for the innocent landowner defense. While this provision could be interpreted to benefit a lender, a lender must also exercise due care upon the discovery of the contamination.

The viability of environmental assessments in qualifying for the innocent landowner defense, as tested in the courts, has yielded varying results. In Int'l Clinical Lab.Inc. v. Stevens, Case No. CV 87-3472, slip op. (E.D.N.Y. Jan. 11, 1990), the court found that because contamination was not visible on inspection, International Clinical Laboratories did satisfy the innocent landowner defense. On the other hand, in BCW Assoc., Ltd. v. Occidental Chem. Corp., No. 86-5947, (slip. op. (E.D. Pa. Sept. 29, 1988), a purchaser and lessees, whose engineering firms reported that the buildings were "free of hazardous waste and contamination", were denied the protection of the innocent landowner defense.

Consequently, MBA is actively participating in a process sponsored by the American Society of Testing Materials, which is designed to develop voluntary industry standards that would specify the steps to be undertaken to constitute "all appropriate inquiry." We hope that this process can be completed in early 1991, and that this product will be a useful means for determining, not only the extent of environmental contamination on a property and the consequent effects on human health (as well as the value of the property), but, also, the specific elements of a due diligence defense. We understand that the American Institute of Environmental Property Auditing is also developing due diligence guidelines.

Even if due diligence protocols are developed and adopted by the industry, the lending community would continue to advocate addressing the problem of lender liability under Superfund through S 2827. Due diligence serves to identify environmental hazards and may

provide a legal defense. The assurance provided by the provisions of S 2827 far exceeds the protection supplied by a legal defense which must be asserted in court.

It is in EPA's interest to construe the "innocent landowner defense" narrowly, and ensure that it is available to the fewest possible parties. We assume that EPA, or private parties could argue that the defense should not apply (1) when hazardous substances are disposed of during the term of the loan and cleanup costs force the borrower to default, (2) an environmental assessment failed to identify hazardous waste, and (3) minimal amounts of hazardous waste were identified at the time due diligence was performed, so although the hazardous waste found was not the waste which prompted the cleanup. This later argument was used in Amoco Oil Co. v. Borden Inc. (889 F 2nd 664)(5th Circ.)(January 23, 1990.)

Enactment of S 2827 will provide a clarification and restatement of Congressional intent regarding lender liability that will instruct the courts, the business community, and parties who view bankers and lending entities as deep pockets, that innocent lenders should not be held liable under Superfund.

Recommendations

The sophistication of the financial markets and lending transactions, and the proactive interpretation and rapidly evolving legal theories of the courts, suggest new issues that the lender liability legislation should address. These issues, which could be addressed in either revised bill language or in the report, accompanying the legislation, are summarized briefly below.

Workouts

MBA believes that the legislation clarifies that lenders who have foreclosed would not be liable for Superfund liability. In addition, it addresses many of the issues in the new test, articulated in Fleet which, raise serious issues concerning potential treatment of lenders' activities with respect to financial management of problem loans and of all outstanding real estate loans. We suggest that the language be revised to deal with the "operator" issue under Superfund. As a practical matter, lenders who deal with a property in default must often take steps beyond merely "securing" a property, that might be interpreted as "operating" a facility under court interpretations of Superfund. In addition, lenders may well end up with a property on their hands for a substantial period of time while they seek a buyer. Some provision should be made to address this circumstance. Consequently, expansion of the bill to clarify coverage of lenders in those situations would be useful.

It would also be helpful for the Committee to indicate that the exemption from Superfund liability for lenders, provided in S 2827, specifically rejects the assumption in Fleet that lenders must act as environmental police officers and bear the liability of their borrowers for contamination they did not cause. We hope the report could indicate that lenders who become involved in workouts or in supervising loans in default may exercise their rights over financial matters of the borrower without fear of liability. Ideally, the legislation should allow lenders to take steps to encourage borrowers to handle contamination responsibly without fear of liability. It is in the public interest for lenders to encourage

responsibly without fear of liability. It is in the public interest for lenders to encourage borrowers to handle contamination responsibly, and this kind of a clarification will allow them to do so without fear of liability.

Definition of Release

We support the language in S 2827 which denies lenders who contribute to contamination the benefit of the exception. Certainly, lenders who contribute to contamination should be liable. However, for the reasons stated above, we fear that the courts have so expansively interpreted the phrase, "contributed to the release," to include almost any actions taken by lenders as "causing or contributing to a release". Provisions that allow lenders to address environmental hazards would, therefore, allow lenders to take action on environmental problems without fear of increasing their liability.

Extent of Exclusion

We appreciate the fact that S 2827 excludes "mortgage lenders" from liability, which we believe will shield mortgage bankers, the real estate departments of insurance companies, pension funds, and other lenders from Superfund liability. In addition, the Committee should clarify that the exemption applies to lenders who did not originate the loan. In Abcor, Inc. v. State Street Bank and Trust Co., D.C. Mass Case No. 88-1324-K, filed August 21, 1988, for instance, a lender who acquired a loan through a merger, has been sued and has agreed, in the context of a settlement agreement, to pay 17 percent of the total liability for cleanup.

Many residential real estate loans are originated by mortgage bankers who close loans in their own names, but immediately sell the loans to others. These lenders are technically in the chain of title, but can have no practical impact on the financial management of the loan either at origination, or on an ongoing basis. Prior to the Fleet decision, MBA would not have assumed that courts would reach back to such an extent and hold such lenders liable. However, given the dicta in Fleet, we believe it would be worthwhile for the Committee to address those lenders who participate in loan servicing or placement.

Consequently, extension of the exemption to lenders and others who acquire and service loans would prove helpful. In addition, the Committee should consider inclusion in the exemption of the Federal secondary mortgage market entities, such as the Government National Mortgage Association, the Federal National Mortgage Association, and the Federal Home Loan Mortgage Corporation. These entities, like the Resolution Trust Corporation, can hold mortgage loans obtained from the primary lender.

Many loans are also pooled or securitized and sold in whole or in part to investors as mortgage-backed securities. Lenders who act as mortgage-backed security issuers do not hold beneficial or equitable ownership on the mortgages, but only hold nominal title sufficient to service the mortgages. Consequently, some clarification as to whether or not this type of security is covered would prove helpful.

Risk Assessment

The Committee has included language requiring banking agencies to take actions "to assure that depository institutions develop and implement adequate procedures to evaluate potential environmental risks that may arise from or at property or operations subject to their lending and fiduciary activities." It also directs HUD to promulgate guidelines to assure that mortgage lenders develop and implement equivalent procedures to evaluate potential environmental risks that may arise from or at property or operations subject to their lending activities.

We ask the Committee to note again that the lender has an economic incentive to evaluate the presence of environmental hazards on a property. MBA is therefore, actively involved in a process to determine voluntary due diligence standards. We hope that the Committee will take this activity into account.

We also hope that the Committee will recognize that certain agencies may have particular familiarity with financing certain properties while they may lack expertise with regard to other types of transactions. Therefor, we suggest that the Committee consider which agency, if any, can appropriately regulate particular types of lenders. We also hope that the Committee will direct the agencies with regulatory authority over specific lenders to take into account existing agency procedures, such as the environmental reviews provided under HUD's current subdivision processing requirements. (Mortgagee Letter 89-9).

In addition, these procedures should be developed in consultation among the federal agencies and affected private parties and entities. Ideally, procedures should be consistent, and reflect the practical realities facing national lenders. We hope these procedures would facilitate, rather than impede, operation of the capital markets, and foster provision of affordable housing.

Shifting the Burden of Proof

We recognize and appreciate the fact that S 2827 amends the Federal Deposit Insurance Act to exempt depository institutions and mortgage lenders from environmental strict liability law. By taking this approach, rather than amending the Superfund law, the legislation would shift responsibility to the government to prove its case, rather than requiring, as under HR 4494, the lender to prove that it has not fallen within the definition of those liable. We believe this provision is one of the most significant features of the bill and applaud the Committee for initiating.

In conclusion, MBA wishes to express its appreciation to the Committee for addressing this issue, and its continuing effort to consider modifications to the legislation that address current concerns. We look forward to working with the Committee to refine S 2827 further and to push for enactment of legislation this year. We would be happy to respond to requests for additional information. Please contact Michael Ferrell or Ann vom Eigen of MBA's Legislative Department for any assistance that you or your staff may require.

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STATEMENT

OF

THE NEW YORK STATE BANKERS ASSOCIATION

ON

S. 2827

THE LENDER LIABILITY ACT OF 1990

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

JULY 19, 1990

Mr. Chairman and Members of the Committee, the New York State Bankers Association, which is the trade association representing New York State's commercial banking industry is pleased to submit the following statement. Our membership consists of independent community, regional and money center banks throughout New York State.

We appreciate the opportunity to submit a statement for the record on the important issue of environmental liability. This issue is extremely important for our member banks which are affected in their capacities as both lenders and corporate fiduciaries.

We strongly support the efforts of Senator Garn and the provisions of S. 2827 that would be a logical resolution of the current uncertainty and inequity experienced by lenders and corporate fiduciaries as a result of the current statutory law and the court decisions that have interpreted the law. S. 2827 would limit the liability of lenders and corporate fiduciaries for nonculpable activities and would more closely reflect the original legislative intent of the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) and the Superfund Amendments and Reauthorization Act of 1986 (SARA) regarding lenders and fiduciaries as innocent third parties. These provisions would provide reasonable and responsible relief for banks from the potentially unlimited liability and operating difficulties banks are experiencing under the current environmental law. We

believe legislation along these lines is necessary to restore the protection intended by the Congress for commercial banks and other lenders who make loans secured by real property. The potential for radical expansion of lender liability implicit in recent court decisions--most notably United States v. Fleet Factors Corp. No. 89-8094, slip op. (11th Cir. May 23, 1990)--fundamentally calls into question lending practices that are well established and deemed necessary for the soundness of the banking system.

Senator Garn's approach in limiting lender or corporate fiduciary liability is well-reasoned and provides appropriate limitations which should allay concerns that may be raised concerning any attempt to thwart the true intent of the environmental cleanup laws.

It is important to stress at the outset that as lenders and corporate fiduciaries, we are as concerned about maintaining a clean and safe environment as anyone else. Our interest in this issue is also to insure that liability for environmental cleanup and associated costs should lie with the appropriate party -- the party who contaminated the property -- and should not be unfairly imposed by judicial determination where it was never truly intended.

I would also like to express our endorsement of the testimony received by the Committee from the American Bankers Association.

## BACKGROUND

### A. Relevant environmental laws

#### 1. Statutes

The enactment of the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), 42 U.S.C. § 9601, et. seq. established the initial standard for environmental lender and fiduciary liability. Section 9601(20)(A) defined an "owner or operator." This definitional section also provided an exemption for lenders, wherein it stated that this term "does not include a person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility;" (emphasis added).

CERCLA also established in section 9607(a), that subject to certain specified defenses, four categories of persons would be liable for all costs of removal or remedial action incurred by the government, any other necessary costs of response incurred, and damages for injury to, destruction of, or loss of natural resources whenever there is a release or threatened release of a hazardous substance which causes response costs to be incurred. This liability is strict, joint and several.

Among the three defenses to the liability imposed by section 9607(a) is the defense for "an act or omission of a third party other than an employee or agent of the defendant, or than

one whose act or omission occurs in connection with a contractual relationship...with the defendant... if the defendant establishes ...that (a) he exercised due care with respect to the hazardous substance concerned, in light of all relevant facts and circumstances, and (b) he took precautions against foreseeable acts or omissions of any such third party and the consequences that could foreseeably result from such acts or omissions;... ."

These sections in CERCLA gave rise to the "innocent third party defense" that has been a focal point of lender and corporate fiduciary liability under CERCLA.

In 1986, the Congress, in the Superfund Amendments and Reauthorization Act of 1986 (SARA) (P.L. 99-499), passed legislation that established a new section 9601(35) which attempted to clarify the parameters of the term "contractual relationship" which related to the third party defense.

Thus, these sections of CERCLA and the 1986 SARA amendments to CERCLA clearly established a defense for innocent third party lenders from the strict liability imposed for a release or threatened release of hazardous substances. This is further supported by the sparse legislative history on these key environmental laws.

### 2. Case law

While there has been much litigation on the issue of lender liability, there are a few

significant cases that are most dispositive of the CERCLA exemption from lender liability and the innocent third party defense for lenders. Judicial interpretation of this defense has become extremely convoluted and has produced results that vary from the original legislative intent of Congress.

The major cases have focused on whether the lender was liable as an "owner or operator" under CERCLA, whether the lender qualified for the limited protection of the lender security interest exemption, or whether the lender successfully raised the CERCLA "innocent third party" defense to protect itself from liability.

In United States v. Maryland Bank & Trust Company, 632 F. Supp. 573 (D. Md. 1986), the Court held that the mortgagee was not exempt from CERCLA liability because it foreclosed on the property that collateralized the loan. The lender's foreclosure on the property rendered it an "owner" under CERCLA and therefore liable for environmental cleanup costs. The Court concluded that the act of foreclosing exceeded the scope of the CERCLA exemption wherein a lender merely holds indicia of ownership to protect its security interest.

Conversely, in United States v. Mirabile, 15 Env't L. Rep. 20994 (E.D. Pa. 1985), the Court held that acts taken by a bank in foreclosure were limited to participation in financial decisions and were not sufficient to render the lender liable as an "owner or operator" under CERCLA. Rather, the bank fell within the CERCLA exemption since its acts were found

to be merely in furtherance of holding "indicia of ownership primarily to protect [its] security interest..." and did not rise to the level of impermissible involvement in the day-to-day operational management of the facility.

As a result of these two decisions and other judicial decisions, it was generally believed that lenders who did not foreclose on property would not be considered "owners or operators" and consequently would not be liable under CERCLA if they did not become involved in the "day-to-day" operational management of the borrower, when the security interest involved property that contained hazardous wastes. However, this has now been thrown into serious question as a result of the decision in the Fleet Factors case, which held that a secured creditor may be liable under CERCLA as an "operator" of a facility, even though it was not an actual operator of the facility. The Court found liability based upon the lenders' participation in the financial management of the facility which the Court concluded was sufficient to indicate its capacity to influence the facility's treatment of hazardous waste. A lender may now be liable under CERCLA even if it does not participate in the day-to-day operational management of the facility.

Thus, although Congress, in crafting the original CERCLA legislation and the amendments thereto, properly recognized that a bank or other lender must be able to take basic and traditional steps to protect its security interest without the threat of incurring environmental liability, the standard of CERCLA liability imposed by the Court in the Fleet Factors case

breaks radical new ground by explicitly imposing liability without being an operator, provided that the secured creditor's involvement with the management of the facility is "sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it so chose."

The unfortunate result is to turn the normal practice of a secured lender, pursued in the interest of sound banking, into an open-ended invitation to environmental liability. A prudent lender should closely monitor a borrower's business - its inventory and accounts receivable, for example. This should be standard operating procedure. Where a loan becomes troubled, the lender may and should go further. The lender may intervene in reorganizing the business to preserve the borrower as an ongoing enterprise. This might involve such workout measures as helping the borrower liquidate assets, working with the borrower's trade creditors, and taking on additional collateral. But the specter of CERCLA liability calls all of these practices into question. Any of these activities, it seems, could "support the inference" that the secured creditor could affect hazardous waste disposal decisions if it so chose.

B. Legislative intent

As alluded to previously in this statement, the legislative intent of the Congress in creating the "owner or operator" exemption from CERCLA liability for lenders that merely "hold indicia of ownership primarily to protect [their] security interest in the vessel or facility" (42 U.S.C. § 9601(20)(A)) and the innocent third party defense (42 U.S.C. § 9607(b)) to the

liability imposed by CERCLA (42 U.S.C. 9607(a)), was to exempt lenders from environmental liability when they act merely to protect their security interest in collateral and do not contribute to environmental contamination.

The section-by-section analysis of CERCLA (H. Rpt. No. 96-172, Part 1), in referring to the term "owner," stated in relevant part that the term "... does not include certain persons possessing indicia of ownership (such as a financial institution) who, without participating in the management or operation of a vessel or facility, hold title ... in order to secure a loan ... ." Also, "... a financial institution which held title primarily to secure a loan ... would not be an "owner" as long as it did not participate in the management or operation of the vessel or facility." Further, in reference to the liability of an "operator," it stated, "[i]n the case of a facility, an "operator" is defined to be a person who is carrying out operational functions for the owner of the facility pursuant to an appropriate agreement."

Although this legislative history is sparse, it is clear that the current judicial interpretations of lender liability under CERCLA are extending liability further than ever intended by the Congress.

## RISKS TO LENDERS AND CORPORATE FIDUCIARIES UNDER CURRENT LAW

### A. Lenders

There are numerous risks and hardships that lenders have experienced since the enactment

**of CERCLA and the 1986 SARA amendments.**

**<u>Liability</u>**

**1. Lenders are reluctant to foreclose on loans that are secured by real property or take title to such property if there is any question that there may be hazardous substances located on the property. If a lender forecloses or takes title to the property to protect its security interest in the loan, the lender would run the risk of incurring liability for all environmental investigations and, most importantly, if any hazardous substances are found on the property, the lender is liable forever thereafter, jointly or severally, under the current law for cleanup costs which may easily far exceed the value of the loan and the value of the collateral. This is strict liability, so even though the lender may never have contributed to any environmental contamination of the property, and did not know or have any reason to know of the contamination, it may still be found to be liable for the full cleanup costs as an "owner or operator" under CERCLA. This liability is also retroactive. Lenders are liable as an owner under current law even if the contamination occurred many years before the lender took title and the lender did nothing to cause or contribute to the contamination.**

**The net effect of the current law is that a foreclosing lender is faced with: unlimited liability for environmental cleanup costs which the bank itself may have to pay and which can, in some instances, place the capital of the lender in jeopardy; diminishment or total obliteration of the value of collateral for its loans; and frequently, the inability to re-sell the**

property in the marketplace once the lender takes back the property.

These difficulties can be demonstrated by an example which occurred in upstate New York. During the latter part of the 1970s a commercial bank held a mortgage on real estate containing a residence and another building where compounds used in the dye industry were produced and processed. The original loan was approximately $50,000 and the borrower was a chemical company located in New York.

Due to a series of unfortunate events, the once solid company failed and the bank charged off approximately $16,000 in 1980. Three years later, the bank acquired the property from the county for the amount of taxes owing in the amount of $12,002. However, the county legislature took the unusual step of passing a special resolution under which the bank was given a quitclaim deed instead of a tax deed. At that time, the bank was not informed that the site had already been placed on the county's superfund list.

Thus far, the bank has been forced to spend nearly $80,000 in consulting and legal fees, testing costs and clean-up charges and has accrued nearly a quarter of a million dollars for possible further remediation. In addition, another bank with which the original bank has a definitive merger agreement, has also spent approximately $100,000 for site testing. The site still remains listed as a hazardous waste site even though numerous tests from the site and adjoining properties have proved negative.

This lender has become extremely cautious about making loans to any business where chemicals or any other hazardous wastes might be found, including gasoline stations and manufacturing plants. In addition to the environmental cleanup costs this lender incurred, the merger proposal had been stalled for over a year because of concerns about the ultimate costs of this one incident.

Loss of collateral / loan losses

2. Since it may be too dangerous for a lender to foreclose on property or take title to the property to protect its security interest when there is a suspicion or a realization that there is either environmental contamination or a threat of such, many lenders have been left with no other option under the law than to forego their security interest in the collateral and to take a loss on the loan rather than subjecting itself to the unlimited liability and resulting cleanup costs. For example, a New York bank referred to above recently had a defaulted second mortgage of $10,000 on a property worth approximately $60,000 to $70,000. The first mortgage balance was approximately $18,000, so there was good equity in the property. However, because there were gasoline and kerosene storage tanks buried underground at the site which had not been tested, the lender decided it would be more prudent to take the $10,000 loss on the loan balance than to risk the chance of a major cleanup expense by the bank.

If the practice of lenders foregoing the benefit of their collateral on a defaulted loan continues without some legislative relief, it will not be long before the cumulative effect will be an adverse impact on lender capital. This defeats the whole purpose of a lender requiring collateral for a secured loan. Secured loan collateral is the critical cornerstone to both residential and commercial lending. Frequently, the only collateral is the real estate on which the loan is made.

Lender "policing" responsibility

3. The Fleet Factors decision specifically contemplates that banks and other secured lenders can, and should, act as environmental "policemen." But lenders are not experts in determining whether property was previously used for storage of potentially dangerous materials, or was once previously subjected to potentially dangerous or hazardous material for which the lender had no responsibility or knowledge. Because they do not have the expertise to detect and assess these risks, lenders are exposed to an additional, unfair, and unmanageable source of risk in the lending function. That Congress did not intend for lenders to take on a policing role is clear from the exemption in CERCLA. For a court to now impose such a role as an incident of the secured lending relationship will only provide a further disincentive to lending, especially by smaller lenders in local communities, without bringing any new expertise to bear on identifying and preventing environmental hazards.

Inability to meet community credit needs

4. In many situations, lenders are concerned about the risk that they will not be able to satisfy the credit needs of their lending communities or certain segments of their communities that rely on lenders for financing. A prime example is the agricultural industry, which is prevalent in western New York State. This is a direct result of the precautions lenders must take to protect themselves against environmental liability under the current law. Otherwise routine loans have been affected in certain industrial areas, including loans to businesses in industrial parks, even where the business seeking the loan has no contamination on its property. However, even these loans are adversely affected when adjoining properties in the industrial park contain hazardous wastes. This credit restriction is also adversely affecting many small entrepreneurial businesses in "high environmental risk businesses" that can not afford the added costs of lender-required environmental testing. Consequently, these customers, which are the mainstay of many communities, are being denied loans by local lenders. Local lenders are currently losing business because of current environmental laws and the measures lenders have been forced to take to protect their safety and soundness. These banks are also losing the goodwill of longstanding customers.

Stifling of economic growth

5. A corollary risk to the increased precautions that lenders have had to impose because of current environmental law, is the long-term effect of a consistent stifling of economic growth due to a reluctance to lend, particularly on ongoing small businesses.

A clear example of the adverse impact this is causing is a situation where a business customer of a commercial bank in upstate New York was forced to file for bankruptcy when the lender, because of environmental liability concerns, was forced to deny any further loans to the company as the company attempted to work itself out of business setbacks.

Judgments and liens were filed against the company in the early 1980s. The bank worked with the borrower to reorganize its debt and entered into several consolidation and extension plans, none of which seemed to solve the borrowers' problems. By the late 1980s, restraining notices from creditors were delivered to the bank and subsequently followed by executions against the borrower's accounts. The bank was precluded from lending more money because the collateral was real estate that the borrower had used to store reclaimed large utility transformers, which were suspected of containing a large amount of oil that may have contained a carcinogenic substance.

This bank's business decision to not make another loan was mandated by the current environmental law. Although the lender did nothing to contribute to any contamination, it ran the risk of incurring environmental cleanup costs if it made further loans to the borrower at that juncture. In this case, the law also unfairly punished a small business borrower. This example is symptomatic of an increasing trend where credit to ongoing financially strapped small businesses is being restricted and the economic viability of ongoing small businesses is in jeopardy. The borrower in this example eventually filed for bankruptcy.

Uncertainty of legal / liability standard

6. Finally, lenders are also experiencing unnecessary environmental risks because there is no clear standard for lenders to follow regarding how they are to reasonably monitor their collateral. The trend in recent judicial decisions leaves lenders in a quandary as to how they can effectively provide necessary services to borrowers, protect their security interests in collateral and the safety and soundness of their lending institutions, and minimize the environmental liability risks to which they may be unknowingly subjecting themselves. Lenders had been led to believe by CERCLA's statutory exemption and the innocent third party defense that they may take steps to monitor their security interests in collateral as long as they do not become an "owner or operator" of contaminated property. However, as a result of recent decisions such as the Fleet Factors case, previously reasonable steps taken to protect a lender's collateral have now been interpreted as rising to the level of being an operator and consequently, rendering the lender liable for the full cleanup costs. In essence, the innocent third party exemption has all but been judicially eliminated.

**B. Corporate fiduciaries**

Like lenders, corporate fiduciaries have experienced increasing risks under the current environmental laws.

**Liability**

**1. The greatest risk to corporate fiduciaries, including both executors and trustees, is the risk that the corporate fiduciary entity and/or individual trust officers will be held personally liable for unlimited environmental cleanup costs when they take title to certain trust or estate real estate assets or provide management services which are routinely expected and provided in the professional administration of an estate or trust. This liability may exist even though the corporate fiduciary did not cause the contamination nor have any knowledge of such, even after making reasonable inquiries.**

This risk is very real in the daily operation of corporate trust services. Fiduciary liability may arise in two contexts. First, if the value of the trust or estate asset being administered by the corporate fiduciary which holds property on which hazardous substances are located is insufficient to cover environmental cleanup costs, then under the current law, it appears that the corporate fiduciary would be at risk for the balance of the cleanup costs. Secondly, corporate fiduciaries who expend trust or estate assets for environmental investigations and for any related cleanup costs are at risk that the beneficiaries will sue the fiduciary over the propriety of expending principal or income that would otherwise directly benefit the beneficiaries.

Corporate fiduciaries are at risk under CERCLA's "owner or operator" liability theory and often fail to successfully fall into the innocent third party category. In many situations, the

steps taken by the fiduciary to inquire into past and current uses of the real property assets are stifled because the corporate fiduciary will not have sufficient time in which to review all prior uses of the property prior to the time of appointment as the fiduciary. This is particularly true when the fiduciary is deciding whether to accept the appointment as executor of an estate that contains real property or closely held stock in a corporation when a major asset of the corporation is real estate that may contain environmental contamination. In this situation, there is not the same orderly flow of events such as when a corporate fiduciary is reviewing the assets it will receive when it accepts a trusteeship. Conversely, delays may be encountered in accepting appointment of the estate so the corporate fiduciary can conduct an environmental review, which may lead to chaos for an estate. Additionally, a corporate trustee may not have direct access to the property in certain situations where it does not have direct management responsibility for the real estate asset.

Loss of customer base

2. Corporate fiduciaries also face the risk of losing valued and longstanding customer relationships, much of which is based on close family relationships developed over many years, because of the effects of the current environmental law. Many corporate trust departments throughout New York must decide whether to turn away business by refusing to accept trust or estate assets that include real estate which may contain hazardous substances, even when the affected property is only one of several trust or estate assets.

A refusal of such business has an adverse ripple effect because the customer may subsequently take away from the fiduciary other unrelated business.

Loss of community access to professional fiduciary management

3. The most unfortunate result of this increasing phenomenon is that the intentions of decedents and donors are being thwarted because the trust or estate is not able to receive the professional fiduciary management which the decedent or donor sought from the corporate fiduciary.

## RESPONSES OF LENDERS AND CORPORATE FIDUCIARIES TO RISKS ARISING UNDER CURRENT LAW

### A. Lenders

Lenders in New York State have responded to the risks that have arisen under the current environmental law in various ways. Each lender seems to take an approach which best addresses its needs. Often the response is tailored to the particular circumstances and there is no readily apparent pattern of responses based on lender size. A common comment from lenders is a feeling that there is a genuine lack of certainty as to exactly what they should do to protect themselves from unnecessary environmental liability and yet still provide the services their customers need.

The range of lender responses to current environmental risks include:

* costly environmental examination of property that will secure new loans
* taking losses on loans and forfeiting loan collateral if it is suspected of containing hazardous waste
* severely restricting lending to certain environmental "high risk" businesses such as farms (because of the presence of chemicals and fertilizers), gasoline stations, manufacturing firms and businesses located in highly industrialized areas where there is storage of materials used in support of manufacturing trades
* avoidance of taking title to property in which the lender already has a loan interest
* avoidance of any action that is considered as operating a facility or providing substantial management advice in loan workouts

**B. Corporate fiduciaries**

Corporate fiduciaries in New York State have also responded to the risks that have arisen under the current environmental law in a variety of ways. Some corporate fiduciaries have instituted very formal environmental risk assessment procedures, while others have more informal procedures in place. There is no discernible distinction between fiduciary procedures, based on the size of the corporate fiduciary. Like lenders, many corporate fiduciaries have expressed concern over the lack of certainty that the procedures they have implemented to protect themselves from unnecessary environmental liability are sufficient, yet will allow them to continue to serve the needs of their customers.

The range of corporate fiduciary responses to current environmental risks include:

* requiring costly physical inspections of all new property and requiring additional environmental testing, if necessary
* turning away property that contains hazardous substances if the corporate trustee determines that the potential environmental liability is too excessive and may expose the institution to unnecessary risks

Finally, we note that there are specialized subsidiaries of trust companies under New York State law which are not technically depository institutions. We would hope that as this bill is considered by the Senate, that these trust companies will also be covered.

## ADDITIONAL COMMENTS AND CONCLUSION

Subtitle B - Limitation on Liability for Nonculpable Activities - of S. 2827, would amend the Federal Deposit Insurance Act, by adding a new section 35 which would greatly clarify the uncertainty regarding lender liability under CERCLA and its amendments. The new section would specifically limit the strict liability imposed by CERCLA. It would exempt an insured depository institution or mortgage lender from strict liability for the release, threatened release, storage or disposal of hazardous or potentially dangerous substances from property that it acquired through foreclosure, held in a fiduciary capacity, or held, controlled or managed pursuant to the terms of an extension of credit. This legislation also establishes reasonable safeguards and limitations. There would be reasonable limitations to prevent

a windfall to the institution and to prevent the use of this exemption if the lender or fiduciary caused the contamination or threat thereof or had actual knowledge of contamination and failed to take reasonable preventive actions. It would also require the development and implementation of procedures to evaluate environmental risks.

We support this attempt to clarify and to restore, through legislation, the original intent of the Congress regarding lender and fiduciary environmental liability under CERCLA. This approach, similarly to the approach in H. R. 4494, sponsored by Congressman John LaFalce, would greatly remedy the current uncertainty over the scope and extent of liability of an innocent lender or corporate fiduciary who has not caused environmental contamination. We look forward to working with the Senate, the House of Representatives and the American Bankers Association as this important legislation moves through the Congress.

WRITTEN STATEMENT FOR THE RECORD

OF THE

RESOLUTION TRUST CORPORATION

ON

LENDER LIABILITY FOR ENVIRONMENTAL CLAIMS

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

July 19, 1990

Good afternoon, Mr. Chairman and members of the Committee. We appreciate this opportunity to discuss lender liability for environmental claims and the potential impact of such liability on the Resolution Trust Corporation.

The RTC considers that the sale of properties from failed thrift institutions is compatible with the preservation of our environment, and we have undertaken a number of measures to sell our environmentally-sensitive properties in a responsible manner. Nevertheless, the potential for lender liability which could pass to the RTC under current environmental laws poses grave concerns for the orderly resolution of failed thrift institutions, for minimizing taxpayer costs, and for protecting the depositors of the nation's banking system.

For these reasons, the RTC supports S.2827. Although the bill does not extend its exemptions to all environmental laws, we view it as a constructive step toward limiting the potential liability of the RTC for hazardous substance clean-up costs and damages under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), or "Superfund", and other laws pertaining to hazardous substances. The testimony of Steven A. Seelig, Director of the Division of Liquidation for the Federal Deposit Insurance Corporation, will address in detail the risks posed by these potential liability claims. These potential claims are applicable to both the FDIC and the RTC in our various conservatorship, receivership, and corporate capacities. While

this statement will incorporate aspects of his remarks, we wish to reiterate the importance of S.2827 to the RTC in limiting lender liability for environmental claims.

The RTC faces potential liability under present environmental laws primarily in our capacity as the receiver or conservator of failed thrift institutions. As you may know, the RTC is required by law to accept an appointment to be the receiver or conservator of a failed thrift institution. Current environmental laws, however, could impose liability on the RTC for clean-up costs and damages from hazardous substances regardless of the involuntary nature of the RTC's ownership and operation and even though the RTC itself acted in a responsible and law-abiding manner.

The impact of these environmental laws is highlighted and, to great extent, exacerbated by a recent case, United States v. Fleet Factors. In Fleet Factors, the Eleventh Circuit Court of Appeals held that a lender can be held liable for Superfund clean-up costs if it participated in the financial management of a facility to such a degree as to permit the inference that the lender could influence the borrower's waste management decisions. Lenders in the past generally had understood that they were protected from Superfund liability if the financial institution was not involved in the daily operations of a facility. As a result of Fleet Factors, the scope of potential Superfund liability may be broadened to include those not directly

responsible for day-to-day operations of a facility. Financial institutions may have to change their lending practices in underwriting loans to borrowers and in dealing with borrowers who are in default in order to reduce their exposure to liability.

The extent to which the RTC may itself be placed at risk under the environmental laws and the recent Fleet Factors case will depend largely upon the number and types of assets which we will be deemed to own or "operate." The RTC, by its very nature as the receiver or conservator of failed thrift institutions, owns thousands of properties--albeit involuntarily and often for very short periods of time. Nonetheless, it may be found liable for hazardous wastes released or deposited on these properties by others in the past. Moreover, since the RTC participates in the financial management of the failed thrift institutions under its jurisdiction, the RTC, as a result of Fleet Factors, could be found directly to be liable in its corporate capacity for an environmental claim otherwise attributable only to the receivership or conservatorship estate. If the RTC is not successful in avoiding such liabilities, particularly in its corporate capacity, the very resources dedicated by Congress to the rescue of savings and loans could be imperiled.

At this time, relatively few properties held by the RTC have been identified as posing environmental risks from hazardous substances. Other agencies and private organizations have

estimated that from 3 to 5 percent of the $170 billion in properties held by thrift institutions under receivership or conservatorship may have environmental problems of some nature. In a preliminary review, RTC regional offices have already identified approximately 300 properties that have the following potential environmental concerns: asbestos (30 percent); above-ground and underground storage tanks (26 percent); landfill/dump sites (11 percent); toxic or hazardous waste (10 percent); and other (23 percent).

These numbers do not indicate that the potential impact on the RTC of clean-up costs will be insignificant: Superfund clean-up costs can be enormous. In the past, clean-up costs, exclusive of litigation costs, have averaged about $5 million. It will not require many findings of Superfund liability before these additional costs will noticeably and adversely affect the cost of resolving the savings and loan crisis.

As long as the RTC or any future purchaser of one of these properties may be held liable for the clean-up costs of environmental hazarda, it will be difficult, if not impossible, for the RTC to sell these assets as it is statutorily required to do. Potential acquirers of failed thrifts and prospective purchasers of RTC property will avoid assuming these risks by requesting indemnifications from the RTC or by drastically reducing prices to accommodate their assessment of potential

environmental claims. At other times, they may outright refuse to purchase certain assets which have been identified as having potential environmental liability claims. In any case, the RTC, and ultimately the taxpayers, will be left "holding the bag," with funds earmarked by Congress to protect depositors and resolve the savings and loan crisis instead being spent on these clean-up costs.

In conclusion, the RTC supports S.2827. We believe that it is appropriate to exempt the RTC from liability under current environmental laws which deal with hazardous subetances to ensure the orderly disposition of insolvent savings and loans at a minimum cost to the taxpayer.

STATEMENT BY

DAVID ROSENBERG

EXECUTIVE VICE PRESIDENT

ENVIRONMENTAL COMPLIANCE SERVICES, INC.

TO THE COMMITTEE ON

BANKING, HOUSING AND URBAN AFFAIRS

U. S. SENATE

JULY 19, 1990

Let me first thank the Committee for the opportunity to submit testimony for your consideration of S.2827.

My name is David Rosenberg. I am Executive Vice President of Environmental Compliance Services, Inc. (ECS) located in Exton, Pennsylvania.

ECS is an organization dedicated to assisting environmental companies with their insurance, safety and compliance needs through the combination of in-house expertise in insurance underwriting, environmental consulting and technical risk management.

ECS Underwriting, our major subsidiary, is a national provider of environmental insurance services; combining underwriting, administrative claims handling and loss control skills. ECS is one of only two companies writing environmental insurance nationwide. ECS Underwriting primarily functions as an underwriting manager for Reliance National Insurance Company and is responsible for underwriting and administering a program of insurance for companies facing an environmental exposure. Our total book of business is in excess of $80 million in annual premiums and includes approximately 600 national accounts. It is safe to say that ECS Underwriting offers the most comprehensive insurance program for those companies facing an environmental liability exposure in the marketplace today.

A policy offered solely through ECS Underwriting is our Pollution Cleanup Policy. The policy pays for the costs of pollution cleanup mandated by a governmental authority. The policy can be designed to provide coverage to protect lenders, operators and buyers and sellers of property.

In discussing S 2827, ECS would like to offer the following comments:

The effects of Superfund on non-culpable parties and activities are felt by a broad range of American business and industry. This includes the lending community. Consequently, it would seem difficult to carve out a special exemption to Superfund for depository institutions acquiring contaminated property through foreclosure, held in a fiduciary capacity or controlled or managed pursuant to terms of an extension of credit.

If an exemption is granted for this industry segment, other business and industry experiencing similar inequities of the Superfund law would also have to be considered. Perhaps it is wiser to examine the overall record of the Superfund program and its procedures to determine liability -a process that can require innocent parties to pay millions dollars to cleanup hazardous waste, while affording them little defense or procedural protection. This may be a question to examine during the Superfund reauthorization in 1991.

In the interim, the best and only strategy for depository institutions or mortgage lenders is a defensive one. The need for environmental due diligence and environmental

risk assessment should be a prerequisite for all institutions making extensions of credit secured in part or in whole by real property. The need for a comprehensive environmental audit or risk assessment cannot be overemphasized. Unfortunately, it is our experience that an audit is often performed by the consultant offering to perform an environmental survey at the cheapest cost. This does not necessarily equate to "proper" due diligence and does not afford the lender adequate protection from potential sources of contamination.

At the minimum, an environmental risk assessment or audit should include the following:

- A site survey or inspection of the facility of the borrower.

- A survey of the surrounding land use to identify all site sources of contamination.

- An assessment of the environmental setting. This should include an assessment of the geological, hydrogeological, topographical, historical, and meteorological trends and surfaces water conditions, both on-site and surrounding areas.

- Regulatory review of current and past activities.

In addition, the lender should explore certain types of risk transfer including pollution

liability insurance coverages. The lender should also make certain to seek full disclosure from the borrower of any environmental hazards and include will drafted protective provisions in its loan documents. It is also suggested that periodic environmental audits be performed audits be conducted in regard to administering the performing loan.

I recently wrote an opinion article for The Journal of Commerce about a House bill, sponsored by Congressman John J. LaFalce, that addresses similar concerns. The article speaks to the issue in even more detail. I am submitting a copy of that article for your consideration

Thank you for the opportunity to present this written testimony. ECS looks forward participating in further discussions on this issue in the future.

The Journal of Commerce
and Commercial
Thursday, June 28, 1990

EDITORIAL/OPINION

# The Bill Goes to the Innocent

By DAVID ROSENBERG

In recent years, environmental liability has been a constant source of new risks for the American business community. Unprepared for the wave of federal and state laws in the early 1980s and the resulting litigation, lenders, insurers, property owners and others are stunned by the high costs of environmental cleanups. Worse, they often have to accept responsibility for contamination to which they contributed little or nothing.

Currently, Congress is reviewing legislation to limit this liability for certain businesses. But the proposed law may cause more problems than it solves because it would limit the liability only of lenders, rather than all segments of the business community.

The principal law defining environmental liability, the Comprehensive Environmental Response Compensation and Liability Act, was passed by a lame duck Congress in 1980. Also known as "Superfund," the act poses great potential liability to secured lenders. It also may result in a company being held liable for the entire cost of cleaning up a hazardous waste site, even if that company sent only a few barrels there.

Superfund authorizes the Environmental Protection Agency to recover cleanup costs from potential responsible parties, including the present or past owner or operator of a facility. That means anyone who transported the hazardous substances for disposal or treatment and anyone who arranged for these services can be liable. The buyer of a contaminated tract of land may be responsible for cleaning it up, even though he did not contribute any part of the contamination.

Parties have been held liable even when they did not select a disposal site, took every precaution to dispose of waste or had the waste transferred to a new site. In some cases, the liable parties did not know where the waste was taken and the disposal occurred during the transportation process.

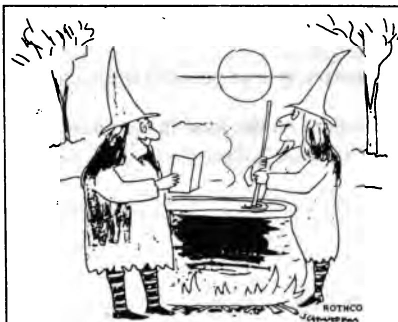
In an attempt to ease this problem, Congress added an "innocent purchaser defense" in amending Superfund in 1986. But, in practice, lenders, insurers and property owners still may not be readily relieved of their responsibility.

The "innocent purchaser defense" is satisfied only when the purchaser makes "all appropriate inquiry into the previous ownership and uses of the property." Consequently, the question becomes not what a buyer knew, but what he should have known.

Now, Congress is beginning to take steps to balance the need to clean up environmental hazards with the expense involved.

Recently Rep. John J. LaFalce, D-N.Y., introduced legislation to protect lenders from Superfund liability when they foreclose on contaminated property. The bill, H.R. 4494, would protect mortgage lenders, charitable institutions and public-sector lenders, such as the Small Business Administration, as well as commercial lenders. It also expands protection to corporate fiduciaries holding title to property for purposes of administering an estate or trust.

Similarly, Sen. Jake Garn, R-Utah, is sponsoring a bill that would reduce, or in some cases eliminate, the Superfund liability of lenders, the Federal Deposit Insurance Corp. and the government's Resolution Trust Corp., the agency disposing of the assets of failed savings and loan associations. The senator wants to avoid spending funds earmarked for resolving the thrift crisis and protecting depositors on environmental cleanups instead.




"It calls for dioxin, but I don't think anyone will notice if we substitute chlordane."

It is true that Superfund has, in recent years, found the deep pockets of the banking community. Most recently, the 11th U.S. Circuit Court of Appeals in Atlanta ruled in U.S. vs. Fleet Factors Corp that a lender that has "the capacity to influence the corporation's treatment of hazardous waste" could be held liable for cleanup costs under the law.

That decision broadens previous judicial rulings that a lender must have participated in the management of a corporation's affairs to be liable for cleanup costs under Superfund. Fleet, which had arranged to auction a bankrupt client's inventory and equipment to recoup its interest instead of foreclosing on a plant, was held liable for the cost of cleaning up asbestos released from the plant during the bankruptcy proceedings. Its cleanup costs may exceed $400,000.

The Fleet Factors Corp. decision is just one of many cases in which lenders and insurers have been found responsible for the cost of a Superfund cleanup. Even those who would appear to be innocent are found liable — especially if they have the "deep pockets" to pay for the remedial work.

The LaFalce bill attempts to resolve this problem for lenders. However, the inequities of the Superfund law are felt by every aspect of society, not just lending institutions. It would be difficult to carve out a special exemption to Superfund for lenders only without invoking the wrath of American business in general.

Perhaps it is necessary to examine the overall record of the Superfund program and its procedures for determining liability — a process that can require companies to pay millions of dollars to clean up hazardous waste while affording them little defense or procedural protection.

*David Rosenberg is executive vice president of Environmental Compliance Services Inc., Exton, Pa.*

STATE OF MICHIGAN
DEPARTMENT OF ATTORNEY GENERAL

STANLEY D. STEINBORN
*Chief Assistant Attorney General*

FRANK J. KELLEY
ATTORNEY GENERAL
P. O. BOX 30212

LANSING
48909

July 31, 1990

Honorable Donald W. Riegle
Chairman Committee on Banking,
Housing and Urban Affairs
U.S. Senate
534 Senate Dirksen Office Building
Washington, D.C. 20510-6075

Dear Senator Riegle:

Your committee has before it S. 2827 which would preempt state liability laws regarding release, storage or disposal of hazardous and dangerous substances from property acquired through foreclosure, held in fiduciary capacity, or mismanaged pursuant to the terms of an extension of credit.

I recently wrote to Congressmen Dingell and Luken (letter enclosed) expressing my strong opposition to H.R. 4494 which amends the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) to allow the disparate treatment among parties who may be liabile for releases of hazardous materials. That bill not only permits lenders to avoid liability for owning or operating contaminated properties, but has the grave potential for such lenders to demand that the public pay for the remediation of property they own, receiving the windfall that results from the restoration of the value of property that has been cleaned up at taxpayer expense.

Many issues, including preemption, raised in this bill are of concern to me and other Attorneys General who enforce the environmental laws around the nation. Such measures merit a good deal of examination and I urge you to ensure that a thorough study of all related issues occurs before the Committee moves ahead on this.

Thank you for your consideration.

Very truly yours,

FRANK J. KELLEY
Attorney General

enclosure

STATE OF MICHIGAN
DEPARTMENT OF ATTORNEY GENERAL

STANLEY D. STEINBORN
Chief Assistant Attorney General

FRANK J. KELLEY
ATTORNEY GENERAL
P. O. Box 30212

LANSING
48909

July 31, 1990

Honorable John D. Dingell, Chairman
Energy and Commerce Committee
United States House of Representatives
Washington, D.C.

Re: House Bill 4494

Dear Congressman Dingell:

I am writing to express my concerns relating to H.B. 4494 sponsored by Congressman John LaFalce and currently being considered by your committee.

As you know, the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) imposes strict, joint and several liability on any party that "owns" or "operates" a facility from which there is a release of hazardous materials into the environment. CERCLA contemplates equal treatment under the law for all parties responsible for environmental contamination whether the party is private, quasi-public, or the federal, state or local government.

H.B. 4494, if passed by Congress, will allow private financial institutions to own, control, and operate contaminated properties "pursuant to the terms of a security interest . . . or for the purpose of administering an estate or trust." Not only will this proposed legislation exempt financial institutions from CERCLA's liability provisions, the amendment will also result in inconsistency and confusion in the interpretation of CERCLA's liability scheme, undermine the evolving public ethic of fostering environmentally responsible corporate conduct, and, most egregiously, will result in direct financial windfalls for lenders at the direct expense of taxpayers.

CERCLA imposes an affirmative duty on a party who seeks to acquire property to ascertain whether property is contaminated prior to acquisition. This statutory imposition of a "due diligence" inquiry prior to the purchase of commercial property

furthers the goal of early identification of contaminated property so appropriate remedial measures can be promptly implemented. Under H.B. 4494, financial institutions may ignore the duty of due diligence and would be able to take legal title, regardless of the condition of the property.

The most substantive benefit of CERCLA to the public is that CERCLA provides incentives to the private and public sectors to adopt policies and practices that are preventive and far-sighted. CERCLA requires that affirmative measures be undertaken to mitigate and prevent environmental injury by closely monitoring and overseeing those activities that may result in environmental damage. Under H.B. 4494 financial institutions would be freed of the statutory requirement to exercise good judgment and circumspection. Lenders would have no incentive whatsoever to facilitate cleaning up the environment even though lenders are uniquely situated to assist in this task. For instance, as preconditions to the execution of any loan, lenders require certain binding warranties and representations from their clients. Lenders also independently examine the sufficiency of the collateral securing the loan. Financial institutions must manage and oversee their loans to ensure their collateral does not become impaired and the ability of their borrowers to repay the loan is not attenuated. Lenders have already implemented policies to make sure their commercial borrowers will not own or control or operate contaminated properties by requiring environmental assessments as well as binding warranties and representations in their loan agreements. H.B. 4494 would remove the incentives financial institutions have to implement the sound commercial practices that have already evolved under the law.

H.B. 4494, contrary to fostering a new ethic of corporate environmental responsibility, will result in the implementation of strategies to evade the liability provisions of the law. The amendment will exempt from the definition of "owner" or "operator" "any corporate fiduciary which has legal title to any facility for purposes of administering an estate or trust." The amendment will result in new and creative efforts to shield parties otherwise liable under CERCLA through placing ownership, management, and control in the hands of a trust.

The cost of remediation escalates with the passage of time, as does the potential for harm to the public health and safety and to the environment. Free of liability, lenders would demand that the government address the environmental hazards extant on their properties after they took legal title. Thus, financial institutions will demand that the public pay for the remediation of property they own, receiving the windfall that

Honorable John D. Dingell
Page 3

results from the restoration of the value of property that has been cleaned up at taxpayer expense.

I believe your committee should oppose any amendment of CERCLA which will result in disparate treatment among parties who may be liable for releases of hazardous materials. H.B. 4494 is particularly pernicious in this regard. I urge you not to respond to the pressures of the banking lobby to weaken CERCLA's enforcement provisions. The states and federal government need to retain all the enforcement tools available to address environmental degradation, one of the major problems facing our nation and the world today.

Very truly yours,

FRANK J. KELLEY
Attorney General

cc: Lynne Ross, National Association of Attorneys General
William Reilly, United States Environmental Protection Agency

STATE OF MICHIGAN
DEPARTMENT OF ATTORNEY GENERAL

STANLEY D. STEINBORN
*Chief Assistant Attorney General*

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LANSING
48909

July 31, 1990

Honorable Thomas A. Luken
Chairman Subcommittee on Transportation
and Hazardous Materials
324 House Annex 2
Washington, D.C. 20515-6120

Dear Congressman Luken:

I understand that your subcommittee will hold hearings on August 2, 1990, on H.R. 4494, amending the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) regarding lender liability.

I am opposed to H.R. 4494 which will result in disparate treatment among parties who may be liable for releases of hazardous materials. This bill would permit financial institutions to ignore their duty of due diligence to inquire whether property is contaminated prior to acquisition and will result in new and creative efforts to shield parties otherwise liable under CERCLA through placing ownership, management, and control in the hands of a trust. Free of liability, lenders will demand that the public pay for the remediation of property they own, receiving the windfall that results from the restoration of the value of property that has been cleaned up at taxpayer expense.

I urge you not to respond to the pressures of the banking lobby to weaken CERCLA's enforcement provisions.

I am requesting that my enclosed letter to Congressman Dingell be made part of the official hearing record on H.R. 4494.

Thank you for your consideration.

Very truly yours,

FRANK J. KELLEY
Attorney General

enclosure

PIRG in Michigan
The Public Interest Research Group in Michigan
212 S. Fourth Avenue #207, Ann Arbor, MI 48104 (313) 662-6597

July 13, 1990

Honorable Donald Riegle
Chair, Senate Banking Committee
U.S. Senate
Washington, D.C.

Re: S. 2319

Dear Senator Riegle:

On behalf of the 35,000 Michigan members of the Public Interest Research Group In Michigan (PIRG in Michigan), I write to you in opposition to S. 2319, a bill that would extend to lending institutions special exemptions from liability for toxic waste cleanup. This bill is yet another attempt to force taxpayers to bail out the savings and loan industry, as well as other lending institutions. Even worse, it would drastically weaken environmental protection throughout the nation, and particularly in Michigan.

As you know, liability for toxic waste cleanup under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), the current federal law, is strict and, where appropriate, joint and several. CERCLA imposes liability on any party--private or public, state or federal--who owns or operates a facility from which there is a release of a hazardous substance into the environment. Although CERCLA provides a number of defenses for so-called "innocent landowners" (those who purchase contaminated property who did not know and had no reason to know the property was contaminated), the exemption is not available to a person acquiring property who knew or should have known the property was contaminated.

S. 2319 would provide lending institutions with several unwarranted and environmentally harmful exemptions to the CERCLA liablity scheme. First, the bill would exempt from liability lending institutions who own, control and operte contaminated properties as a result of a voluntary foreclosure or as a result of administering an estate or trust. This exemption essentially would give lending institutions a special liability shield, even if they contributed to contamination at a site.

Second, S. 2319 would treat lending institutions who voluntarily foreclose on contaminated property differently from

other acquirers of contaminated property. It would provide them with a blanket liability exemption, removing their incentives to assure that property which is the subject of mortgages and other security interests is free from contamination. It would remove their incentive to attempt to ascertain whether property was contaminated before foreclosing on that property. Other purchasers of property must exercise due care before purchase; lending institutions should not receive special treatment under the law.

The consequences of this bill would be harmful to the environment and to taxpayers. First, contaminated sites would be discovered later and would be cleaned up more slowly than is the case today. Presently, lenders require environmental audits as a condition for lending. If S. 2319 becomes law, this practice will likely cease because the lender can never be held liable for environmental damage under CERCLA. Also because the language in the bill in some cases actually exempts lenders from liability even when they themselves contribute to the contamination through management or control of the property the bill in fact would <u>prevent</u> the government from ordering property owners to remediate their sites and would <u>prevent</u> the government from forcing polluters to pay for cleanup.

Second, the amendment would place the federal Superfund in the role of the FDIC and FSLIC by insuring against environmental risks for the lending community. If a property is foreclosed after a bank made a loan to a known polluter, EPA or the state would have to clean up the property at taxpayer expense The lender could then sell the newly cleaned up property and reap a windfall--all at taxpayer expense. Although S. 2319 differs from its House counterpart, H.R. 4494, in that it exludes from the liability exemption anyone who "benefits" from a government-financed cleanup, the provision is vaguely worded and would at most allow the government to recover the increased value of the property rather than the cost of cleanup.

We in Michigan have a special concern with the exemptions proposed in this bill. The Michigan Legislature currently is considering bills that would establish a state Superfund law modelled on CERCLA. The financial institutions in our state are seeking exemptions similar to those in S. 2319. We believe that those exemptions in state law, coupled with exemptions in federal law, would bring to an end the role that financial institutions have played in identifying toxic sites and assisting in their cleanup. The consequences of such exemptions for Michigan, and our 2700 toxic waste sites, would be devastating.

Thank you for considering our position. We ask you and members of your Committee to oppose S. 2319, and any other bill that would slow down cleanups and shift the burden of paying for them from polluters to the taxpayer.

Sincerely,

Andrew Buchsbaum
Program Director

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MICHIGAN UNITED CONSERVATION CLUBS
2101 Wood St. ● P.O. Box 30235 ● Lansing, MI 48909 ● 517/371-1041

July 18, 1990

John D. Dingell, Chairman
House Energy and Commerce Committee
House Office Building
Washington D.C. 20515

Dear Chairman Dingell:

On behalf of the Michigan United Conservation Clubs, I am writing you to urge you to oppose pending legislation in Congress that would dramatically weaken environmental protection under the Comprehensive Environmental Response, Compensation, and Liability Act, known as "Superfund." The legislation, H.R. 4484 (S. 2827), would give blanket liability exemptions for savings and loans, banks, and other lenders at a time when environmental protection should be encouraged, not short-changed.

As you may know, the Michigan Legislature is presently considering a package of comprehensive amendments to the Michigan Environmental Response Act (MERA), the state version of Superfund. One of the most important issues in the development of the MERA amendments is the potential liability of financial institutions for the remediation of contaminated property which lenders may own or otherwise control. The Michigan United Conservation Clubs has strongly opposed efforts by S&L's, banks and other lenders to limit liability under MERA, and we are similarly opposed to efforts at the federal level to accomplish the same objective.

Under current Superfund law, lenders have an affirmative duty to assess property used to secure a loan for environmental contamination. This usefull obligation has encouraged lenders and their borrowers to act prudently and responsibly to address environmental problems as a precondition of loan approval. H.R. 4494 and S. 2827 would simply remove this duty, allowing banks to lend to known polluters and actually perpetuating the existence of polluting enterprises.

To make matters worse, when such ill-conceived loans go sour, S&L's, banks and other lenders can turn to the Superfund or state superfund programs to clean up the contaminated property and then profit from the sale of the remediated property. This is nothing short of another "taxpayer bailout" for the S&L's and banks.

As chairman of the House Energy and Commerce Committee with principal jurisdiction over this issue, we strongly encourage you to exercise your leadership role and oppose this harmful and misguided legislation.

Sincerely,

Tom Washington

Thomas L. Washington
Executive Director

cc: Gov. James Blanchard
Sen. Vern Ehlers
Sen. Lana Pollack
Rep. Tom Alley
Mr. David Hales, Director/DNR
Bill Roberts

Federal
Home Loan
Mortgage
Corporation

Leland C. Brendsel
Chairman
Chief Executive Officer
703/759.8500

August 16, 1990

The Honorable Donald W. Riegle, Jr.
Chairman, Senate Committee on Banking,
Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Riegle:

The Federal Home Loan Mortgage Corporation (Freddie Mac) appreciates the opportunity to express our views on S. 2827. This bill would clarify the liability of mortgage lenders and federal banking agencies for environmental contamination under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA).

S. 2827 was introduced by Senator Garn after several recent Federal Courts construed provisions of CERCLA to hold mortgage lenders liable for cleanup costs of hazardous waste sites acquired by the lenders through the foreclosure process.

In a recent Federal Appellate Court decision, United States v. Fleet Factors Corp., 901 F.2d, 1550 (11 Cir. 1990), the court held that the exemption from Superfund liability does not extend to a secured creditor whose involvement with managing a facil ty might "support the inference that t could affect hazardous waste disposal decisions if it so chose." Under this ruling, it is possible that a lender could be required to bear the costs of cleaning up contaminated property even if the lender had no knowledge or role in the creation of the contamination, or management responsibility over the property.

This trend has the very real potential of placing great burdens on the lending community, which will ultimately lead to increased costs to the borrowing public. Further, it could lead to greater reluctance among lenders to provide financing for the housing industry.

The effect of S. 2827 would be to exempt mortgage lenders from liability under CERCLA when they acquire property through foreclosure and are not responsible for the contamination. Freddie Mac does not fall within the bill's definition of a "mortgage lender" or "federal banking agency" and is therefore not protected by the legislation in its present form.

33-661 - 90 - 12

The Honorable Donald W. Riegle, Jr.
August 16, 1990
Page 2

Freddie Mac should be included within the protection of S. 2827 because, for purposes of this legislation, Freddie Mac stands in the shoes of the primary mortgage lender. As the holder of the mortgage, Freddie Mac forecloses and becomes the owner of property when a borrower defaults We hold the mortgage on the properties, but we exercise no management or control over the properties. In fact, because we purchase loans on a wholesale basis from the primary lenders who underwrite and service those loans, Freddie Mac must rely on the primary lender s inspections of the properties for all information concerning the property.

The secondary mortgage market's importance to the housing industry is well recognized. Freddie Mac and the Federal National Mortgage Association (Fannie Mae) provide mortgage lenders nationwide with an indispensable source of mortgage financing In 1989, these two companies purchased 49 percent of all conventional residential mortgages originated During the first quarter of 1990, Freddie Mac and Fannie Mae purchased nearly 60 percent of those loans Freddie Mac and Fannie Mae also have large multifamily loan purchase programs Legislation to protect only the mortgage lenders, when the majority of residential loans are sold to Freddie Mac and Fannie Mae, would be inconsistent in theory and practice. It does not give full consideration to the role that the secondary mortgage market plays in housing finance.

In response to the environmental concerns, Freddie Mac has been working on industry standards for due diligence to identify possible environmental hazards We saw the need to provide homeowners with safe, affordable housing as well as the need to protect lenders and other participants in the lending process from unwarranted liability for cleaning up hazardous conditions they did not create Toward this end, Freddie Mac and Fannie Mae jointly sponsored the Housing Industry Environmental Hazards Working Group, comprised of private and governmental groups. We will continue to work to establish industry-wide due diligence standards for lenders, buyers, and sellers of property.

I urge you to amend S. 2827 to include secondary mortgage market entities within the exclusion from liability for innocent owners of property.

Again, we appreciate your consideration of our views. We would be glad to provide any additional information or input as this proposal moves through the legislative process. If you have any questions or concerns, please call at (202) 789-4750.

Sincerely,

Leland Brendsel

Leland C. Brendsel
Chairman and Chief Executive Officer

# national council of health facilities finance authorities

July 18, 1990

Committee on Banking, Housing,
and Urban Affairs
United States Senate
534 Dirksen Office Building
Washington, D.C. 20510

Re: Lender Liability Act of 1990

Dear Committee Members:

The National Council of Health Facilities Finance Authorities ("the Council") is the national association of 26 "Authorities" created by their state legislatures to issue tax-exempt bonds for not-for-profit and public health care organizations in these states. These Authorities provide the financing that allows states and communities to provide the health facilities needed by their citizens.

Tax-exempt financing is the primary mechanism for financing not-for-profit and public health care facilities These bonds finance the renovation or replacement of facilities that are obsolete or in violation of health and safety codes, the purchase of major equipment, and some new facilities construction. Council members issue approximately two-thirds of all health care facilities bonds.

The members of the Council are increasingly concerned about the possibility that environmental risks may adversely affect their ability to perform their functions. This concern is heightened because the hospital industry is now facing a serious problem regarding bankruptcies and defaults on loan obligations as a result of the current crisis in health care and the falling and now often negative margins of hospitals, in part as a result of restrictions in Medicare capital and operating reimbursement payments.

In general, the relevant elements of the process of hospital finance are:

1. The authority issues tax-exempt bonds which are sold to individuals, mutual funds, or financial institutions including commercial banks.

2. The authority loans the bond proceeds to the hospital, secured by a mortgage on the hospital;

3. A trustee is appointed, usually a commercial bank trust department;

4. In many cases, the bonds are "credit enhanced" to enhance their marketability and reduce their interest rate. Credit enhancements include letters of credit issued by commercial banks and mortgage insurance provided by the Department of Housing and Urban Development under the Federal Housing Administration's section 232 and 242 programs. In New York and New Jersey alone, HUD/FHA insures over $3.5 billion of hospital mortgages.

Our analysis of the language and purpose of the bill indicates that it would apply to the authorities and their trustees. Based on this analysis, the Council strongly supports this legislation.

Sincerely,

Paul C Fiduccia

Paul C. Fiduccia
Counsel
National Council of Health
Facilities Finance Authorities

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20250

AUG 1 1990

The Honorable Donald W. Riegle
Chairman
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

S. 2827, a bill recently introduced and referred to your committee, includes a Subtitle B called the "Lender Liability Act of 1990." This subtitle relieves certain lenders from liability for response costs stemming from hazardous wastes when the lenders would otherwise be liable for such response costs, on a "strict liability" theory, even though they had no knowledge of the presence of the hazardous wastes on the property.

While this bill extends the exemption it creates to private banks and a large number of Federal banking regulatory agencies, the list of entities mentioned in subsections (b) and (d) of Subtitle II does not include Farmers Home Administration and the Rural Electrification Administration, two agencies within this Department that act as secured lenders.

The exemption that this bill affords, however, is equally as important to FmHA and REA as it is to any other public or private lender or lending regulator. We thus wish to call your attention to this apparent oversight, and to suggest that secured lending activities conducted by the Secretary of Agriculture be included in both subsections (b) and (d) of Subtitle II of S. 2827.

Sincerely,

Roland R. Vautour
Under Secretary
Small Community and
Rural Development

**FARM CREDIT SYSTEM ASSISTANCE BOARD**

Suite 702
1301 Pennsylvania Avenue, NW
Washington, DC 20004

Eric P. Thor
President and Chief Executive Officer

(202) 737-9255

July 23, 1990

The Honorable Donald W. Reigle, Jr.
Chairman of the Committee on Banking,
Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510-6075

Dear Senator Reigle:

I am writing to you to request that the Farm Credit System Assistance Board be included among the federal entities covered by the new section 35 to be added to the Federal Deposit Insurance Act (Act) under Senator Garn's bill, S. 2827. As you know, that section shields from liability for hazardous substances several federal entities charged with regulating, assisting, or liquidating financial institutions. These entities are presently exposed to such liability simply by virtue of the exercise of their statutory responsibilities. Specifically, among other things, S. 2827 grants immunity to these federal entities "in connection with the provision of . . . financial assistance" and "property received."

The Assistance Board is similarly situated to the federal entities covered in Senator Garn's bill. Like the Federal Deposit Insurance Corporation and other federal entities, the Assistance Board is currently providing financial assistance to troubled Farm Credit System (System) institutions. Also, the Assistance Board, by act of Congress, assumed the assets and liabilities of the Farm Credit System Capital Corporation, a clearing-house for System institution acquired properties. The Capital Corporation managed and, in addition to other interests, had ownership interests in assets and acquired properties in several states as a result of its attempts to assist System institutions. Following dissolution of the Capital Corporation as required by our enabling statute, the Assistance Board arranged for the repurchase of these loans and acquired properties by System institutions.

The changes to the Act regarding immunity for certain federal entities from liability for hazardous substances are appropriate.

To the extent that the Assistance Board is similarly situated to these entities, we respectfully request that the Assistance Board be included among the federal entities covered by the proposed amendments to section 35 of the Act and exempted from this potential liability. We would be happy to discuss a few technical changes to the bill that would be necessary to accomplish this.

Sincerely,

Glenn
Agr...

AAEL
American Association
of Equipment Lessors

August 1, 1990

**HAND DELIVERED**

Senator Jake Garn
Ranking Minority Member
Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

Re: S.2827

Dear Senator Garn:

I'm writing to you on behalf of the American Association of Equipment Lessors (AAEL). We support legislation that encourages capital investment by clearly marking the limits of potential liability for banks and other financing sources under the various federal and state environmental laws.

Your bill would insulate certain "mortgage lenders" and "insured depository institutions" (including affiliated leasing companies) from liability

> under any law imposing strict liability for the release, threatened release, storage or disposal of hazardous or potentially dangerous substances from property--
>
> (1) acquired through foreclosure;
> (2) held in a fiduciary capacity; or
> (3) held, controlled or managed pursuant to the terms of an extension of credit [, which includes lease transactions that are "functionally equivalent to a secured loan" and that comply with banking regulations] [S.2827 at pages 9-10]

The immunity would disappear if the otherwise immune entity (1) caused a release or disposal of hazardous substances; or (2) with actual knowledge that hazardous substances were present, failed to take reasonable action to prevent a release or disposal of such substances S 2827 also provides that an otherwise immune entity would be liable to the extent that it received any "actual benefit" from a waste cleanup action.

Our basic submission is that, while your bill protects bank-affiliated leasing companies, it does not cover the majority of leasing activities that should be protected from inappropriate environmental liability. To begin with, S.2827 is not as clear as it might be that its limited environmental

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immunity applies in cases involving personal property and equipment, as well as in cases involving real property. Your bill does not provide any protection for non-bank related leasing companies that engage in lease financing activity identical to the bank leasing activity that is protected under S.2827. Moreover, the limitation of immunity in S.2827 to lease transactions that are "functionally equivalent to a secured loan" does not clearly protect the full scope of traditional lease finance activities-- by both bank leasing companies and non-bank leasing companies-- where the lessor acts as a financing source, without operating the property or equipment or causing or contributing to any release of chemicals or other hazardous materials causing environmental damage.

Today the equipment leasing industry accounts for well over 30% of all capital investment in the United States each year, placing over $130 billion worth of equipment in service annually in the United States. Non-bank related leasing companies provide about 70% of this lease financing, while 30% is provided by bank leasing companies. Moreover, non-bank leasing companies provide lease financing services that are essentially identical to those of bank leasing companies. Given these facts, it should be apparent that the purposes and intended economic benefits of S.2827 would be better achieved if the legislation made no distinction between the environmental law liability of bank leasing companies and that of non-bank leasing companies engaged in essentially the same lease financing activity. To make this sort of distinction would distort the marketplace, creating different risks of environmental liability, with resulting differences in pricing and documentation, for different kinds of leasing companies all of which are engaged in the same identical economic activity. There is no justification for this result.

Moreover, the omission of non-bank leasing companies from environmental immunity under the current bill conflicts with the purpose of the legislation to insulate federally insured banking institutions from overwhelming environmental liabilities. This is because non-bank leasing companies commonly obtain their funding from federally-insured banks. The imposition of ruinous environmental liability on non-bank leasing companies, and their potential insolvency, would have an immediate impact on the financial health of federally insured banks.

The objectives of S.2827, as well as basic fairness, would be better served under a bill recognizing that all leasing companies should receive the same scope of immunity from environmental liability when they engage in essentially identical lease financing activity. Outlined below are (1) the important role that equipment leasing plays in assisting capital formation in this country, (2) a description of the

uncertainties that now exist about a finance lessor's potential liability under the "Superfund" statute (42 U.S.C. §9601 et seq.), and (3) a suggestion for legislative language to be added to S.2827 at an appropriate time to address the problem.

## BACKGROUND

1. Equipment leasing in America. The volume of equipment leasing in this country is now over $130 billion a year, representing well over 30% of all capital investment in the United States each year. Second only to the commercial paper/-bond market, leasing is the second largest source of investment capital for business, industry and agriculture in our Nation's economy. AAEL is the major national trade association in this multi-billion dollar industry, with approximately one thousand member companies engaged in every conceivable aspect of equipment leasing.

Equipment leasing is commonly utilized, at least in part, by virtually every segment of our National economy. Types of equipment leased include computers, office equipment, manufacturing and industrial equipment, as well as transportation equipment. Facilities leasing is also becoming more common today, with tax incentives encouraging lessors to provide the financing and investment capital needed to build special types of facilities -- such as wastewater treatment plants, and facilities that generate electricity from municipal solid waste or used tires-- that are operated by others for essentially public purposes. Equipment leasing is one of the major options for American businesses to obtain needed capital equipment.

2. The impact of federal and state environmental liability laws on secured lenders and lessors. The strict liability standards, now in a wide variety of federal and state environmental laws, operate to make it difficult or impossible for many projects to obtain needed financing. "Owner and operator" strict liability exists at the federal level, and must be considered by secured lenders and finance lessors of covered "facilities", under both "RCRA" and the federal "Superfund" statute. See Resource Conservation and Recovery Act (RCRA), 42 U.S.C. §§6924, 6925; Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA or "Superfund"), 42 U.S.C. §9601 et seq., as amended by the Superfund Amendments and Reauthorization Act of 1986 (SARA), Pub.L. No 99-499 100 Stat.1613. The majority of the States and certain local governments have adopted similar environmental liability laws imposing strict liability for waste cleanup costs on "owners or operators". Together these environmental laws exert a "chilling effect" on financing by secured lenders and finance lessors, who must assess the risk that they may be characterized as "owners or operators" subject to strict

liability for enormous environmental cleanup costs.

The only environmental law that attempts to exempt nonculpable financing activity is the federal Superfund statute, which states that "secured lenders" are not "owners or operators" and will not be held strictly liable as "owners or operators" under the Superfund statute. See 42 U.S.C. §9601-(20)(A). But even here, the Superfund statute is not as clear as it might be in exempting from liability wholly passive finance lessors of equipment, who invest in a transaction but who do not participate in managing, operating or servicing the leased equipment or facility. The statutory history suggests that such passive finance lessors should be immune from Superfund liability under the "secured lender" exemption in 42 U.S.C. §9602(20)(A).[1] But the statutory language does not clearly reflect this history. This is unfortunate since lenders and finance lessors provide essentially similar financing services; they offer competing methods of financing; and they should be treated equally under the Superfund statute.

Yet another "chilling effect" on financing stems from recent court decisions interpreting the Superfund statute to mean that a secured lender or lessor that forecloses on a facility that turns out to be contaminated with hazardous waste can be held liable for the entire cost of the cleanup plus damages, even if the lender or lessor in no way contributed to

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[1] Congressman Harsha introduced the "secured creditor" exemption to the bill that was finally passed stating:

> This change is necessary because the original definition inadvertently subjected those who hold title to a * * * facility, but do not participate in the management or operation and are not otherwise affiliated with the person leasing or operating the * * * facility, to the liability provisions of the bill.

Remarks of Cong.Harsha, reprinted in 2 Senate Comm. on Environmental and Public Works, 97th Cong, 2s Sess., 2 A Legislative History of the CERCLA 945 (Comm.Print 1983). And see H.R.-Rept 96-172 Part 1 96th Cong., 1st Sess. at 36 (1979) reprinted in 5 1980 U.S.Code, Cong.& Admin. News 6181 ("owner" does "not include certain persons possessing indicia of ownership (such as a financial institution) who, without participating in the management or operation of a vessel or facility, hold title either in order to secure a loan or in connection with a lease financing arrangement under the appropriate banking laws, rules, or regulations.").

the hazardous waste problem at the facility.[2] See, e.g., Guidice v. BFG Electroplating and Mfg.Co., 732 F.Supp.556 (W.D.Pa. 1989). See also United States v. Fleet Factors Corp., 901 F.2d 1550 (11th Cir. 1990). The so-called "innocent landowner" defense to Superfund liability applies most clearly to real estate (not personal property), and it requires an expensive environmental assessment before it can be invoked. See 42 U.S.C. §9601(35)(A)-(B), §9607(b)(3). The cost of an environmental assessment, which can range from $2,000 to well over $100,000, raises the cost of financing to effectively foreclose financing for many small businesses and other projects.

Toxic waste cleanups often cost millions of dollars, which may be more than the value of the financing or the property itself, and CERCLA contains no limit on the amount of liability. Traditionally, lenders and finance lessors are not in a position to monitor the activities of the businesses which they finance, since they play no role in the management or operation of these businesses and also do not have staff with expertise in managing environmental matters. Moreover, if lenders and finance lessors were to try to increase their participation in management, they might well expose themselves to potential Superfund liability as "operators" of the financed business. See United States v. Fleet Factors Corp., supra (11th Cir., May 23, 1990). Faced with this dilemma, many lenders and finance lessors have stopped extending financing to businesses where there is even the smallest risk of hazardous waste contamination.[3] Other lenders and finance lessors have

[2] There have been no cases discussing the potential Superfund liability of equipment lessors. But equipment lessors are particularly concerned about the possible impact of Superfund on them in two situations: (1) where the lessor is a passive finance lessor of transportation equipment such as aircraft, motor vehicles, or railroad rolling stock (all of which are Superfund "facilities") from which there is a spill of toxic chemicals and (2) where the lessor is a passive finance lessor of a facility (a wastewater treatment plant, or electric generating plant, for example) that is possessed and operated by others.

[3] This has dried up financing for many worthwhile projects-- including wastewater treatment plants, cogeneration facilies, and small business projects such as gasoline service stations, print shops, cleaning shops, and farm equipment-- where there is even the smallest risk of environmental liability. The impact is particularly harsh on small business. According to a recent poll by the American Bankers Association (ABA), canvassing those banks who have assets of $250 million or less, "43 percent of respondents have already stopped making

continued to extend financing in some but not all cases, but only at a premium price that reflects the risks and uncertainties of Superfund liability.

Congressman LaFalce has introduced a bill (H.R.4494) that addresses some of these problems by attempting to overturn recent court decisions that misinterpret the federal Superfund statute to impose strict liability on nonculpable activities of secured lenders. AAEL supports the spirit and general intent of H.R.4494. But secured lenders and finance lessors must deal with other federal and state environmental laws imposing strict liability, as well as the federal Superfund statute.

The impact of the present complex scheme of federal and state laws imposes strict liability for environmental damages in circumstances that are not clearly defined, with enormous potential damages that can not be easily quantified. These laws make arbitary distinctions, threatening to impose strict liability on some secured lenders and finance lessors, but not on others that are providing essentially the same financing services. Overall, the impact is choking off the flow of capital financing to many desirable projects. Our AAEL members in recent months have been unable, because of the fear of environmental law liabilities, to complete the financing of a variety of lease finance transactions including, for example, projects to build new wastewater treatment plants, the financing of environmental cleanup equipment, and the lease financing of service station facilities that would have been operated by small businesses

FINANCE LESSORS' AMENDMENT TO S. 2827

Your bill, S.2827, addresses these problems by protecting "mortage lenders" and "insured depository institutions" (including affiliated leasing companies) from liability under federal and state environmental laws when they hold, control, manage or foreclose on property that turns out to be contaminated This is entirely appropriate. These institutions are sources of financing; they do not cause or contribute to the release of hazardous substances into the environment. Imposing Superfund liability on them would only undercut capital formation and the flow of capital for many environmentally beneficial projects.

loans altogether to certain types of small businesses, those that [are] most frequently associated with environmental problems, and another 11 percent plan to do so shortly." Hearings before Senate Banking Committee on S.2827, Tr.65-66 (statement of Charles M. Mitschow) (July 19, 1990).

AAEL submits that all finance lessors, whether bank affiliated or not, should be shielded from inappropriate environmental liability. Traditional tort law principles have long immunized finance lessors from strict tort liability because of their lack of involvement with the leased equipment. See Fraser, Application of Strict Tort Liability to the Leasing Industry: A Closer Look, 34 Bus.Law. 605 (1979); see also Uniform Commercial Code §2A-407; §2A-103(1)(g). As Congress recently recognized in the Price-Anderson Act, there is no sound policy reason to impose "ownership" liability on finance lessors who do not possess or control a leased facility. See 42 U.S.C. §2210r, 102 Stat.1078. Today finance leasing plays a vital role in our Nation's economy. To safeguard this important source of investment, and to keep a "level playing field" for the choice between different kinds of financing (secured lending vs. leasing) to acquire capital equipment, the same environmental immunity should be extended to companies engaged in lease financing, on the one hand, as is extended to companies engaged in secured lending, on the other hand.

To be specific, we propose that the following new section 1103 be added to Subtitle B ("Limitation on Liability for Nonculpable Activities") on page 12 of S.2827:

**SEC.1103. LIABILITY.**

(a) EXEMPTIONS.-- (1) Title 12 of the United States Code ("Banks and Banking"), is amended by adding a new chapter 42:

**CHAPTER 42-- LIMITATION ON LIABILITY FOR NONCULPABLE ACTIVITIES OF BANKS AND FINANCE LESSORS**

**§4101. Definitions**

For purposes of this chapter--

The term "designated lessor" means a person who, without participating in the management of a vessel, facility or other property during the term of the lease, holds an ownership interest, or beneficial ownership interest, or security interest, in the vessel, facility or other property, and participates as a lessor, or as an equity participant or investor in such lessor, in a sale-leaseback financing arrangement or other lease financing arrangement involving the vessel, facility, or other property. For purposes of this chapter, a person shall not be deemed to participate in the management of a vessel, facility or other property unless the person actually exercises such control that it amounts to domination and operation of the vessel, facility or other property.

**§4102. Exemption from strict liability under environmental laws.**

No secured lender or designated lessor shall be liable under any law imposing strict liability for the release, threatened release, storage or disposal of hazardous or potentially dangerous substances from a vessel, facility or other property, where the secured lender or designated lessor acquires ownership, possession or control of the vessel, facility or other property pursuant to a lease arrangement or sale-leaseback financing arrangement or security interest involving the vessel, facility or other property.

Except that this exemption from liability for secured lenders and designated lessors shall not apply to any person that has caused the release or threatened release or disposal of a hazardous substance or similar materials from a vessel, facility or other property that gives rise to a removal, remedial, or similar action.

The impact of the amendment we propose would put all finance lessors and secured lenders on an equal footing, and would accord them limited immunity from state and federal environmental law liability, in accordance with the principles in S.2827.[4] We also believe that our proposed amendment, like Congressman LaFalce's bill (H.R.4494), fairly implements the original intent of the "secured lender" exception in the federal Superfund statute (see 42 U.S.C. §9601(20)(A)).

[4] Our proposal differs from the present version of S.2827 in two respects: First, the whole idea of extending immunity to secured lenders and passive finance lessors-- who may well "know" that hazardous substances are being used by the borrower/lessee, particularly in environmentally beneficial projects such as facilities that generate electricity from municipal solid waste or used tires-- is inconsistent with holding them liable for "fail ing] to take all reasonable actions necessary to prevent the release or disposal of such [hazardous] substance". Once again, secured lenders and finance lessors are passive entities who do not take any active role in management. They should not be held liable for maintaining the passive role that is the basis for immunizing them in the first place Second when secured lenders and finance lessors foreclose on or repossess the collateral that has been cleaned up by others, our view is that they receive--not a "windfall"--but simply the value of the property as they and others perceived it at the time the financing was extended. Our proposal reflects this view.

Our proposal would legislatively overrule the 11th Circuit's recent decision in United States v. Fleet Factors, 901 F.2d 1550 (11th Cir. 1990). The opinion in that case interprets the "secured lender" exemption in the Superfund statute, and the statutory language "without participating in management" (42 U.S.C. §9601(20)(A)), to mean that a secured lender or finance lessor who never exercises sufficient control to become an "operator" and never forecloses its security interest to become an "owner" is nevertheless liable if its involvement in financial management is sufficient to infer that it could affect waste disposal decisions even if it did not. See 901 F.2d at 1557- 1560. This outcome creates a new class of liable parties not contemplated by the CERCLA statute: a secured lender or finance lessor can become liable without being either an "owner" or an "operator". This is an extreme departure from the words of the statute, previous case law, and the original intent of Congress. Moreover the 11th Circuit s decision is bad policy. The impact of the decision if accepted, would encourage secured lenders and finance lessors either to withhold financing from many worthwhile projects, or to rewrite their loan/lease agreements to make it clear that they have no say whatsoever about the borrower/lessee's waste disposal decisions.

Our proposed language, by contrast, provides a "bright line" test that will provide certainty, while allowing finance lessors to continue their traditional practices for safeguarding the value of the facility or other property, and allowing the continued flow of capital financing for many needed projects including wastewater treatment facilities and waste cleanup or anti-pollution equipment. Cf. Interpreting the Meaning of Lender Management Participation Under Section 101(20)(A) of CERCLA, 98 Yale L.J. 925 (1989).

Thank you for considering AAEL's views on this important issue. Our industry is concerned about the "chilling effect" that state and federal environmental laws are now having on lease financing projects. We look forward to your earliest favorable response.

Yours very truly,

Michael J. Fleming

Michael J. Fleming
President, AAEL

cc: Members of the Senate Committee
on Banking, Housing, and Urban Affairs

CLEAN SITES

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Alexandria, Virginia 22314
(703) 683-8522
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July 30, 1990

The Honorable Donald W. Riegle, Jr., Chairman
Senate Committee on Banking, Housing, and Urban Development
SD-534 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Riegle:

Clean Sites is an independent 501 (c) (3) non-profit organization dedicated to speeding the cleanup of hazardous waste. We have worked at more than 60 hazardous waste sites, using the knowledge we have gained in the field to improve public policies that govern hazardous waste cleanup.

We would like to express our interest in S 2827, a bill before your committee that would affect the liability scheme in the hazardous waste cleanup law, the Comprehensive Environmental Response, Compensation and Liability Act of 1980, known as Superfund. Specifically, the measure would provide some relief of this liability to financial institutions. We favor an administrative remedy to the extent possible at this time.

We think that lenders with only a security interest and that have conducted due diligence environmental audits should be protected. In most cases, we think that current law has provided these protections. It has also produced a new and needed awareness on the part of buyers, sellers and lenders that playing a role in the operation, handling or management of hazardous waste brings with it the prospect of strict, joint and several liability. As a result of this new awareness, many more facilities have been cleaned.

Like Mr. Garn, the bill's sponsor, we also are concerned that Superfund not broadly endanger the ability of small businesses to receive loans from financial institutions. Clearly, we cannot afford to have lending institutions inappropriately shy from making loans to any businesses. Nor can we afford to jeopardize or in any way hamper the work of the Federal Deposit Insurance Corporation and the Resolution Trust Corporation.

The Honorable Donald W. Riegle, Jr.
Senate Committee on Banking, Housing, and Urban Development
July 30, 1990
Page 2

At the same time, we recognize the importance of questions raised in connection with foreclosures in recent court cases, including *U.S. v. Fleet Factors Corp.* Neither the "secured creditor exemption clause" nor the "innocent landowner" defense, which Congress added to Superfund law in 1986, clarify this and other real estate/lender transactions issues to the extent needed.

We agree with the Environmental Protection Agency and with environmentalists, however, that we should try to solve the problem administratively, to the extent possible. EPA should issue guidance or promulgate a rule as necessary that clarifies definitional issues raised in *Fleet Factors* and similar cases, including the types of activities lending institutions may carry out and still have only a "security interest" and what constitutes "due diligence." We think that the leadership of the Congressional committees with jurisdiction over Superfund should urge EPA to issue guidance or promulgate a rule as necessary as soon as possible.

Only if the administrative approach fails and after the scope of the problem for small businesses and federal agencies has been fully documented, should Congress consider a change in the law. Even then, the Garn bill -- or any legislation -- may have unintended consequences. For example, current law does not consider a lender an owner or operator of a facility if its only "indicia" of ownership is its security interest in the property. S2827, however, could eliminate liability for lenders no matter how involved they may become in the day-to-day operations of a borrower.

Superfund's liability provisions lie at the heart of our current strategy for cleanup. If the liability scheme still is at issue after EPA issues its guidance the problem should be considered as a whole in the context of the entire law when it is reauthorized substantively.

The health of our financial institutions and the ability of our federal government to protect their vital functions is of overriding importance to the health and well being of the American people. But let us act in a way that has the greatest chance of succeeding while not endangering the Superfund's protections.

I request that you include this letter as part of the record of the July 19th hearing on S 2827. Thank you.

Sincerely Yours,

Thomas P. Grumbly
President

cc: Sen. Joseph R. Biden, Jr.
Sen. Quentin N. Burdick
Sen. Jake Garn
Sen. Frank R. Lautenberg
Mr. Russell E. Train

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

NOV 30 1990

OFFICE OF ENFORCEMENT

The Honorable Donald W. Riegle, Jr., Chairman
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

Thank you for the opportunity to testify before your Subcommittee on July 19, 1990 regarding the proposed "lender liability" legislation, S. 2827. By this letter, I am submitting answers to the written inquiries you forwarded to EPA on July 20, 1990. The Agency is also in receipt of your September 27, 1990 letter and is in the process of addressing your additional concerns.

As the enclosure indicates, the Agency has undertaken an extensive survey of our regional offices in order to provide the data sought in your July 20, 1990 letter. I hope these responses assist you in your consideration of this important matter. If you have any questions regarding these responses, please contact me or have your staff contact David B. Van Slyke, the Acting Associate Enforcement Counsel for Superfund. Mr. Van Slyke can be reached at 382-3050.

Sincerely yours,

James M. Strock
Assistant Administrator

Enclosure

Printed on Recycled Paper

RESPONSE TO FOLLOW-UP QUESTIONS FROM SENATOR RIEGLE RESULTING FROM THE JULY 19, 1990 HEARING BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

Question No. 1

"When do you expect the Administration to state its position on S. 2827?"

Response to Question No. 1

While the Administration does not oppose limited legislation that meets the general goals set forth in the August 2, 1990 testimony of Mr. James M. Strock before the House Subcommittee on Transportation and Hazardous Materials of the Committee on Energy and Commerce (see Exhibit A), we are unable to comment on the specifics of this particular bill at this time. The Administration's preference is to further define some critical terms affecting lenders within the existing CERCLA liability scheme. This can be achieved by promulgation of an expedited rulemaking. The rule would preserve the original intent of Congress of protecting lenders from CERCLA liability, by interpreting the "security interest exemption" in Section 101(20)(A). This rulemaking is being undertaken in conjunction with a broader review of other, possibly related, areas of secondary liability under CERCLA. We expect the Administration to state its position when the process of promulgating the lender liability rule, including responding to comments on the proposed rule, is completed.

Question No. 2

"You testified [at pages 4-5 of your prepared statement] that the "innocent landowner" defense is available under Section 101(35) of the Superfund law to governmental entities such as the Federal Deposit Insurance Corporation and the Resolution Trust Corporation, and "EPA is willing do (sic) discuss application of these provisions to FDIC, RTC and other similar federal entities."

I am very interested in the availability of the "innocent landowner" defense not only to the FDIC and RTC, when they act in a custodial capacity, but also to those entities, when they act in their corporate or non-custodial capacity.

I encourage your immediate discussion of the Federal and (to the extent of EPA's expertise) State Superfund laws with the FDIC and the RTC. Following those discussions I would appreciate receipt of the report you offered in your testimony. In your report I would want to be advised of any possible circumstances in which the deposit insurance funds or RTC's corporate assets may be at risk to satisfy liabilities that arise under the Federal and State Superfund laws."

Response to Question No. 2

The "innocent landowner defense," contained in CERCLA Section 101(35), is available to lenders generally and explicitly protects government entities that acquire property involuntarily. EPA interprets this latter provision as applicable to the RTC or FDIC if they come into either ownership or possession of a facility as receiver or conservator, or in a corporate capacity. Government entities that are voluntary owners or operators, along with other owners and operators (aside from those acquiring by inheritance or bequest), must satisfy certain other elements of the defense. A subsequent owner or operator must demonstrate that: (1) it made all appropriate inquiry (e.g., conducted a "due diligence" search) regarding the property prior to its acquisition; (2) at the time of acquisition, the owner or operator had no reason to know that any hazardous substances that are the subject of a release were disposed of at the facility; and (3) it exercised due care in the event a release or threat of release of a hazardous substance occurred.

While the "innocent landowner defense" will continue to be available to lenders, far greater certainty will be provided to the RTC, FDIC, and like agencies by the forthcoming rule addressing lender liability generally. This rule should offer an up-front exemption to liability under certain circumstances. By interpreting the "security interest" exemption to clarify when lenders are not considered "owners" or "operators," rather than relying only on this defense to liability, the transaction costs inherent in pleading and proving this defense will be avoided. Also, the likelihood that lenders would be named as third parties or be the subject of contribution actions is greatly diminished. Our attached list of cases (Exhibit B) includes those few filed cases in which FDIC or RTC assets "may be at risk." This approach will also address the issue of security interests held by other agencies that acquire property in a custodial or involuntary manner (e.g. seizure, forfeiture or for unpaid taxes).

Question No. 3

"EPA Administrator William K. Reilly is quoted in the press as having stated on June 19 that "it is not the federal government's 'intention' to hold banks and other lenders liable for cleanup even if they own property contaminated with hazardous waste." The article and your testimony indicate that the EPA and the Department of Justice are reevaluating issues regarding the liability of lenders and other "secondarily liable" parties.

If Mr. Reilly issued a statement, please provide it for the record. Further, please indicate what precisely Mr. Reilly intended by his comments."

Response to Question No. 3

Mr. Reilly's remarks concerning "secondary liability" were reported in the June 22, 1990 edition of the Environment Reporter. No prepared statement, however, was issued.

The quotation attributed to Mr. Reilly and cited by Senator Riegle, that "it is not the federal government's 'intention' to hold banks and other lenders liable for cleanup even if they own property contaminated with hazardous waste," while accurate, was directed at lenders who hold properties solely as the result of foreclosure. It was not intended to be construed as advocating a blanket release of lending institutions from all CERCLA liabilities. As Mr. Reilly further stated, "we need to figure out a better way to cut the difference (between Superfund liability and those secondarily liable parties who have no knowledge or reason to know about the hazardous waste problem)."

EPA's current proposal to accomplish this "intention" was more thoroughly explained by Mr. James M. Strock in his August 2, 1990 testimony before the House of Representatives' Committee on Energy and Commerce, Subcommittee on Transportation and Hazardous Materials (Exhibit A). While some of the "secondary liability" issues are still under study, the expedited rulemaking concerning the "secured creditor exemption" should add certainty to the applicability of the CERCLA liability scheme to lenders.

Question No. 4

"You testified [at pages 8-9 of your prepared statement] that EPA intends "to issue guidance on the definition of 'participating in the management of a facility' under the secured creditor exemption to the definition of 'owner or operator.' Do you similarly intend to revise and clarify the guidance on landowner liability that you issued on August 18, 1989? To what extent does EPA believe that it can address current concerns of lenders in any administrative clarification of the "innocent landowner" defense?"

Response to Question No. 4

EPA does not currently anticipate that the landowner liability guidance, published in the Federal Register on August 18, 1989, will need to be specifically amended. It is anticipated that EPA's rule, however, will address the issue of liability of government entities that acquire property involuntarily, which is one element of the "innocent landowner" defense.

Question No. 5

"Is EPA actively considering any alternative method of funding the clean-up of hazardous substances that does not rely upon the imposition of strict liability upon private parties? What alternative(s) are being considered?

Response to Question No. 5

EPA is not actively considering any alternative funding method for hazardous substance cleanups at this time. As Mr. Strock stated in his August 2, 1990 testimony, the Administration's preference is to retain the current CERCLA liability scheme, but at the same time, define some of CERCLA's key statutory terms to ensure that the needs and concerns lenders and federal agencies that involuntarily acquire property or acquire property through foreclosure, forfeiture, seizure or other means, are adequately protected from CERCLA liability.

Question No. 6

"What data are available to the EPA regarding clean-up costs under the Federal Superfund law that lenders have paid either directly to the EPA or a State enforcement agency or by contribution to a private party or otherwise?"

Response to Question No. 6

A list documenting lender involvement and potential or adjudged liability at CERCLA sites is attached (Exhibit B). We do not, however, have access to complete information regarding third party and State level enforcement suits.

Question No. 7

"What data are available to the EPA regarding the clean-up liability that agencies or instrumentalities of the Federal Government have incurred by reason of such entities' direct loans or insurance or guarantee of private lenders' loans?"

Response to Question No. 7

A list documenting federal agency or instrumentality involvement at CERCLA sites is attached (Exhibit B).

Question No. 8

"Does EPA believe that judicial interpretation of the provisions of the Federal Superfund law that most directly affect lenders has extended the law beyond Congressional intent in enacting Superfund? If you hold such belief, please indicate your specific reasons for doing so."

Response to Question No. 5

EPA understands that various judicial decisions regarding lender liability have created some uncertainty within the lending community over the status of lenders under the CERCLA liability scheme. However, as noted in Mr. James M. Strock's August 2, 1990 testimony, the Agency is planning to define, in a manner that adds certainty to the statute as drafted, in an administrative rulemaking, the key sections of CERCLA that most directly affect lenders.

**STATEMENT OF
JAMES M. STROCK
ASSISTANT ADMINISTRATOR FOR ENFORCEMENT
UNITED STATES ENVIRONMENTAL PROTECTION AGENCY**

**BEFORE THE
SUBCOMMITTEE ON TRANSPORTATION
AND HAZARDOUS MATERIALS,
COMMITTEE ON ENERGY AND COMMERCE
UNITED STATES HOUSE OF REPRESENTATIVES**

**August 2, 1990**

Good morning, Mr. Chairman and members of the Committee. I am James Strock, Assistant Administrator for Enforcement at the United States Environmental Protection Agency. Thank you for the opportunity to be here today to discuss the liability of lending institutions, corporate fiduciaries, and various Federal financial institutions under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended (CERCLA or "Superfund"). You have also asked for the Agency's views on the proposed legislation, H.R. 4494, and other related bills currently before Congress.

EPA is well aware of the concerns expressed by the lending community regarding CERCLA liability and we do not want uncertainty about liability rules to inhibit financial transactions unnecessarily. My testimony before the Senate Committee on Banking, Housing, and Urban Affairs, on July 20, 1990, outlined several efforts that the Agency is willing to undertake to analyze the possibility of further defining the liability of lending institutions under this nation's hazardous waste laws. Since the July 20, 1990 hearing, the Agency has attempted to further define the concepts that we believe would add certainty to the <u>current</u>

liability scheme. In doing that we have discussed the issue at great length within the Agency and have met with representatives of the Department of Justice (DOJ) and the Resolution Trust Corporation (RTC). As a result of that deliberation and those discussions, we believe that we have a proposal that offers an equitable and fair solution to concerns of the lending community. We would like to explain this proposal to you today, and hope that this will provide a basis for further discussion.

The Administration's preference is to retain the CERCLA liability scheme as it now stands, but to add further definition to the critical terms of the statute, through an expedited rulemaking, in a manner that preserves the original intent of the security interest exemption from liability as a CERCLA "owner or operator," thereby avoiding potentially inequitable treatment of lenders.

Our starting point for analyzing this issue is the statute, CERCLA, itself. The liability provisions of CERCLA, found in Section 107, generally provide that owners or operators, parties that were owners or operators at the time of disposal of the hazardous substances, generators of hazardous substances, and transporters of hazardous substances who select the disposal site are liable under CERCLA for remediating the site in question or reimbursing the Superfund trust fund in the event the United States undertakes the cleanup using Superfund monies. The liability provisions typically in question regarding lending institutions are Sections 107(a)(1) and (2), which state that "the owner or operator

of a vessel or facility, [or] any person who at the time of disposal of any hazardous substance owned or operated any facility at which such hazardous substances were disposed of ... shall be liable for all costs of removal or remedial action incurred by the United States ...." The liability of owners and operators is not contingent on proof that they caused the release or threatened release of hazardous substances.

Under Section 107 of CERCLA, lenders, like other entities involved with hazardous waste sites, may be potentially liable as either past or present site owners or operators. Congress, however, in defining "owner or operator" in Section 101(20)(A) provided a specific exclusion from the definition of owner or operator for "a person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility." This is known as the "secured creditor exemption" and has been in CERCLA since it was first passed in 1980. As is noted in greater detail below, it is this section of the statute that the rulemaking will focus on in further defining the liability of lenders under the statute.

The liability section of CERCLA, in Section 107(b)(3), also details the three available defenses to CERCLA liability: when the release or threatened release was caused by (1) an act of God; (2) an act of war; or (3) an act or omission of a third party other than an employee or agent of the defendant, or one whose act or omission occurs in connection with a contractual relationship,

existing directly or indirectly, with the defendant. Section 101(35)(A) contains a definition of the term "contractual relationship," added when CERCLA was reauthorized by the Superfund Amendments and Reauthorization Act of 1986 (SARA), which clarifies Congressional intent to afford owners a defense to liability, the so-called "innocent landowner defense," under certain specific circumstances. Under the facts of a particular case, this contractual relationship defense may be available to lenders. That is, a subsequent owner or operator does not incur liability under CERCLA for prior releases caused by acts of a third party if the subsequent owner or operator made: (1) all appropriate inquiry (e.g., a "due diligence" search) prior to acquiring regarding the property; (2) acquired the property with no reason to know that any hazardous substances that are the subject of a release were disposed of at the facility; and, (3) exercised due care in the event a release or threat of release of hazardous substances occurred.

In order to ensure that the law functions as intended, EPA believes it is preferable to clarify the exemption already created by Congress specifically for lending institutions (i.e., the secured creditor exemption) rather than attempt to create an additional exemption or redefine the available defenses. Further definition of the secured creditor exemption will allow EPA, the Federal Agency charged with interpreting and implementing CERCLA, to address the circumstances under which lending institutions may become liable in the first instance, as opposed to looking at

potential defenses once liability is triggered. We believe that EPA can craft this rule expeditiously and in a manner that is credible, defensible, and will be deferred to by federal courts. The rule would add certainty since it would reduce the lenders' current difficulties in assessing when the security interest exemption is applicable or the innocent landowner defense is available. It would also avoid the transaction costs inherent in asserting the innocent landowner defense and reduce the potential for becoming a third party defendant or the subject of a contribution action. In addition, it would obviate the requirements placed upon Federal agency lending institutions under section 120(h) when they transfer property that has come into their possession as a result of the foreclosure situation.

As noted above, Congress' definition of an "owner or operator" in Section 101(20)(A) provided a specific exclusion for "a person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility." EPA's proposed regulatory interpretation of this provision would provide that a lending institution who actually obtains title to contaminated property, as long as it meets the requirements delineated in the rule, would qualify for this exemption. The exemption would extend to receivers or conservators of the estate of the foreclosure mortgagee, such as RTC, who may acquire title pursuant to operation of Federal law. The interpretation, under certain circumstances, would also extend to a lender that has not taken title to the

property but is involved with the property to protect its security interest. This interpretation is intended to mitigate the potentially harsh results which may occur, for example, when a foreclosure mortgagee is forced to take title in order to protect his security interest.

The goals of the rule would be to ensure that lenders (1) are not liable parties so long as they act responsibly with regard to any property they take title to or are administering without taking title, (2) do not reap a benefit from any response action performed on the property by the government, and (3) exercise some care in making the loan and in monitoring the facility to ensure that the collateral does not incur environmental damage during the life of the loan.

To meet these goals, EPA proposes to interpret the phrase "holds indicia of ownership primarily to protect his security interest" in a manner that excludes from the definition of owners or operators those lenders who administer or take title merely to protect their security interest, such as where a borrower can not continue his obligations under the loan. We believe that this is what Congress intended in passing the original statute in 1980. However, the rule will also require, consistent with the goal that the lender act responsibly with regard to the facility, that the lender undertake some affirmative obligations with regard to environmental matters at the facility in order to take advantage of this exception. The rule would recognize, however, that such responsibility is limited due to the fact that the lender's

interest in the property is of a different nature than a voluntary owner. In particular, this requirement is analogous to the obligations and duties of a receiver to protect and preserve both the physical (real and personal) property of the estate and to preserve the assets of the estate. For example, in looking at the RTC responsibilities under FIRREA, the RTC may act as a receiver for a defunct Savings and Loan in certain circumstances.

Accordingly, EPA's interpretation of "holding an indicia of ownership primarily to protect a security interest" will include the obligation to act responsibly when knowledge of contamination exists. One standard that has been suggested regarding what it means to be acting in a reasonable manner with regard to the facility in this context is that the lender must act with due care and failure to exercise due care to address environmental hazards would cause the lender to lose the benefit of the "indicia of ownership" exemption. While we are still looking at this issue, this standard of due care may be appropriate since if is the applicable standard for receivers under prevailing caselaw and is the standard employed in the third-party defense in CERCLA § 107(b)(3). In fact, in discussing the standard in the legislative history of CERCLA, the conferees recognized that "the due care requirement embodied in section 107(b)(3) only requires such person to exercise that degree of due care which is reasonable under the circumstances." Conf. Rpt. at 187. If the person does not exercise due care, under our proposed interpretation he is no longer insulated from CERCLA liability as an owner.

To meet our second goal, ensuring that the person or entity foreclosing does not receive a windfall as a result of actions taken by the government to address contamination existing on the property, the rule will clarify that in those situations where the government has incurred costs in responding to a release or threat of release at the property and thus the value of the property has increased, the lender is only entitled to recover his security interest to the extent of the value of the property at the time of the lender's intervention. This will be done by crafting the regulation in a manner that recognizes the existence of the lien provision of CERCLA, Section 107(l), which creates a lien on contaminated property up to the amount of the expenditures made by the United States. The requirements should operate to provide an incentive to lenders to take appropriate steps to preserve the collateral (here, the property) throughout the life of the loan.

Assuming the lender exercises due care, upon a subsequent sale of the property, under the regulation, the lender would be entitled to the lesser of: (1) the fair market value of the property at the time of foreclosure, or (2) the amount of the secured interest. The remainder of the sale monies would then be used to satisfy the lien placed on the property by operation of the statute, and any remainder monies would go to satisfy the loan amount and the excess above that amount would revert to the previous owner. If the foreclosure mortgagee undertook activities which were beneficial to the environmental conditions at the property, the amount

expended to conduct these activities would be added to the adjusted security interest value.

The foreclosure mortgagee or lenders who have not yet taken title also must make the statutory showing that it was an entity who was not "participating in management" of the facility. To provide relief in those situations where the foreclosure mortgagee must be involved with the property in order to realize his security interest (the "workout" situation), the rule would likely exclude from the definition of "management" certain actions taken to administer the property. In particular, in an effort to provide some protection for those actions which are necessary to address contamination at the site, EPA will not consider actions which have the effect of reducing environmental harm to be "participating in management." Such "workout" activities, however, could only continue for a relatively short period of time, after which the owner will be considered as "participating in management" of the facility. In addition, the lender's activities must be in the nature of custodial care in winding down the affairs of the borrower or otherwise proceeding to pass title or operation to a third party that will own or operate the facility. As indicated above, the continuing requirement to exercise due care would ensure that any instances of mismanagement may subject the foreclosure mortgagee to CERCLA liability. As a result of this interpretation, actions taken to avoid CERCLA liability will not have the undesirable effect of incurring CERCLA liability.

Lenders have also voiced the concern that subsequent purchasers of contaminated property are also potentially liable and that these properties are, hence, worthless. From our recenmt conversations with RTC, we understand that very few of the properties which they may ultimately assume will likely acquire Superfund status and require an extremely costly cleanup. Hence, while some properties may go unsold due to concerns regarding liability for a CERCLA cleanup, the great majority of sites with some contamination would still be marketable; the environmental liabilities simply would be factored into the purchase price or other terms of the deal (e.g., indemnification). EPA's proposed interpretation would do nothing to discourage lenders from taking appropriate action with regard to the initial loan and would also encourage lenders to monitor the collateral to ensure that it has sufficient value in the event that foreclosure to realize on the security interest is necessary. It will simply make good business sense for the lender to look at the property carefully at the time of the loan and for the purchaser to take similar precautions at the time of any subsequent sale.

For those sites which may require major cleanups, EPA recognizes that in some cases it may be advisable to offer some relief to potential buyers of the property. In this situation, the Agency could offer, in its discretion, a covenant not to sue [and contribution protection??] to a prospective purchaser of contaminated property in exchange for some cleanup or other environmentally beneficial activity by the prospective purchaser.

This would insulate the otherwise non-liable party from any potential liability, would create an environmental benefit and may allow the lender to realize the amount of his loan. EPA has undertaken such settlements and we will continue to exercise our discretion to enter into prospective purchaser agreements consistent with Agency guidance. (See "Guidance on Landowner Liability under Section 107(a)(1) of CERCLA, De Minimis Settlements under Section 122(g)(1)(B) of CERCLA, and Settlements with Prospective Purchasers of Contaminated Property," issued to Agency personnel on June 6, 1989 and published in the Federal Register on August 18, 1989, at 54 F.R. 34235.) To date, EPA has exercised this discretion in agreements at three Superfund Sites: 1) Bofers; 2) Bunker Hill; and 3) Boliden.

In summary, we are confident that an administrative fix can be proposed in the very near term that will afford lenders some protection and certainty under the statute. We look forward to working with our sister federal agencies on this matter and will report back to you on our progress in the very near future.

You have also asked the Agency to address the issue of corporate fiduciary liability at this time. As you know, this is not only an issue in the lending institution field but impacts all categories of potentially responsible parties under the statute. EPA and the Department of Justice are currently, in what we believe to be in the best interests of the public, attempting to ensure consistent litigating positions under CERCLA. Specifically, we are undertaking a review of our litigation positions regarding certain

entities who may not be the primary persons responsible for the generation, transportation, or release of hazardous substances, but nonetheless became liable under CERCLA. Within the category of "secondarily liable parties" we include, for example, lenders and trustees of testamentary or real estate trusts that own facilities, as well as corporate fiduciaries. This matter is, however, being reviewed by EPA and DOJ in the context of reviewing the generic issues associated with secondary liability. We hope to have that legal review completed by October 15, 1990.

EPA's proposed clarification of the secured creditor exemption will have a tremendous impact on the lending community as they would not incur CERCLA liability in the first instance as opposed to other options which would just make certain defenses available to lenders (i.e., innocent landowner defense). However, we would note that the Agency must be cautious in this endeavor, since it may open the door to others who have similar types of arguments or may structure transactions in a manner that does violence to the scheme proposed here. With careful crafting, the express requirements which are necessary to qualify for this exemption should nonetheless be sufficient to ensure clear rules.

This concludes my prepared remarks. I am happy to answer any questions that you may have.

**EXHIBIT B**

**PRELIMINARY LIST OF CERCLA CASES INVOLVING LENDER LIABILITY**

The following listing is broken down by Region into three categories: 1) CERCLA actions involving private lenders; 2) CERCLA actions involving Federal lenders; and 3) CERCLA actions involving private lenders where the liability does not result from the lender-borrower relationship.

**CERCLA CASES INVOLVING PRIVATE LENDERS**

**REGION I**

Silresim Chemical Corp. site - In re Union National Bank

A chemical waste recycler at the site, for which Union National Bank held a mortgage, encountered financial difficulties The Bank undertook a supervisory role in the financial management of the company In that role, the Bank's agent also participated in aspects of the business, such as managing the flow of wastes within the facility and arranging to dispose of the company's inventory As a result of the "business" participation by the Bank, EPA sought to recover past response costs from the Bank, which agreed to pay $504,000 out of a total settlement with the bank and others of $3.4 million. The total settlement represented 95% of EPA's past cost claim. Recovery of EPA s past costs was settled administratively under CERCLA § 122(h on March 26, 1990 In addition, on September 21, 1988, a group of 200 generator defendants at the Silresim site filed a contribution action against State Street Bank, its holding company and Union National Bank which was allegedly owned and controlled by State Street Bank. Selection and performance of a remedial action for the site is forthcoming; Union National Bank and other PRPs remain subject to potential enforcement action for the site remedial action.

Keefe Environmental Services site - United Federal Savings and Loan

United Federal Savings & Loan (United Federal) held a mortgage on the property and subsequently foreclosed. After acquiring the property at the foreclosure sale, United Federal held the property for approximately six weeks United Federal thereafter sold the 17-acre parcel for less than $4,000. During its period of ownership, United Federal declined to take any action to abate the site's deteriorating conditions. EPA was force to undertake emergency pump-down activities to prevent the overflow of a 1 million gallon capacity waste lagoon located on-site On March 19, 1986, the United States entered into a consent decree with United Federal Saving and Loan whereby United agreed to pay $150,000 to resolve their potential liability at the Keefe site.

## REGION III

Turco Coatings site - United States v. Mirabile

The United States sued the former landowner, who sued American Bank and Trust and Mellon Bank as operators at the site due to financial control over operations at the facility. American Bank and Trust was also pursued as an owner since it had foreclosed on the property and purchased it at the sheriff's sale. The court denied summary judgment in favor of Mellon, finding that Mellon had exercised both financial and operational control over the facility while it held secured interests at the site. (U.S. v. Mirabile, 15 ELR 20992 (E.D. Pa. 1985)). The United States' claim for costs incurred by EPA was subsequently settled with the former landowner. (See below for discussion of the SBA's involvement in this case.)

California Maryland Drum site

Maryland Bank and Trust foreclosed on a mortgage at this site and purchased the property at the foreclosure sale with knowledge that trash operations were conducted onsite. The bank, who exercised such ownership rights as conveyance of a portion of the property to a third party, negotiation of an easement, and leasing out a portion for cultivation, refused to clean up hazardous wastes on the site and was named by EPA in a cost recovery action. The court ruled that the bank's security interest, and ability to avail itself of the secured interest exception terminated upon foreclosure. (U.S. v. Maryland Bank & Trust, 632 F. Supp. 573 (D. Md. 1986)). The case subsequently settled.

Cuyahoga Wrecking site - In re Cuyahoga Equipment Corp.

EPA has spent more than $8 million at this site and expects to spend between $14 and $40 million more. The U.S. has just lodged a settlement with the Freedom Savings & Loan Association (FSLA) and the debtors in this bankruptcy action, in which the FSLA will receive a release from liability based on its representation that it did not participate in the management of the facility, and the United States will receive $600,000 plus interest. The settlement resolves the U.S.' objection to an agreement between the debtor and FSLA to give FSLA the $1.6 million the debtor has received from selling an option to purchase the contaminated property, on which FSLA holds a mortgage. The U.S., which spent millions of dollars stabilizing the property environmentally, had contended that it was entitled to recover some of its costs under 11 U.S.C. § 506(c) since it was standing in the shoes of the trustee, who had refused to clean up the property as required by law. In re Cuyahoga Equipment Corp. et al., No. 86-B-12206 (Bankr. S.D.N.Y.).

McAdoo site - U.S. v. Alcan

The United States did not elect to sue First Valley Bank. One of the defendants has filed a motion to add First Valley Bank as a third party defendant. The motion, filed on February 27, 1989, is still pending.

BFG Electroplating site - U.S. v. National Bank of the Commonwealth

EPA filed suit against the Bank on August 19, 1988, on the theory that the Bank held title to the property, through a foreclosure, during the disposal of hazardous wastes at the site. Numerous leaking barrels of electroplating waste sat on the site during the time the Bank managed the property and took rent from the lessee The total remedy amounts to approximately $247,000, of which the Bank has agreed to pay $47,500. A consent decree settling the matter was lodged with the court on June 7, 1990. On September 1, 1989, a district court denied the Bank's motion for summary judgment in a third party suit, holding that the secured creditor exemption did not apply to the Bank post-foreclosure. (Guidice v. BFG Electroplating and Mfg. Co., 732 F.Supp. 556 (W.D. Pa. 1989)).

REGION IV

Swainsboro Print Work site - U.S. v. Fleet Factors

The United States named Fleet Factors Corporation, a commercial factor, in this action seeking $374,234, filed on July 9, 1987. Fleet's alleged liability was based, in part, on its handling of barrels of hazardous waste and removal of machinery in a manner that released asbestos in the course of selling off personal property on which it had foreclosed. A more detailed discussion of the factual and legal history of this matter is contained in the district court decision, U.S. v. Fleet Factors, 724 F.Supp. 955 (S.D. Ga. 1988), and the U.S. Court of Appeals decision, U.S. v. Fleet Factors, 910 F.2d 1550 (11th Cir. May 23, 1990), reh denied, No. 89-8094 (11th Cir. July 17, 1990) (affirming the district court's denial of Fleet's motion for summary judgment).

National Galvanizing site - U.S. v. Carolina Galvanizing

National Galvanizing owned realty that was contaminated with hazardous waste. Carolina Galvanizing sought to acquire the property. Carolina bought a note from the Chase Commercial Bank worth $100,000 for one-fourth its value and was assigned the mortgage on the contaminated site. National Galvanizing was in default on the loan, but the Bank did not foreclose, nor did

Carolina after their acquisition of the note. After EPA undertook removal action, Carolina foreclosed on the property and took title to the property The U S brought suit against Carolina alleging it was liable under two theories: (1) pre-foreclosure - held indicia of ownership (mortgage) as a mechanism of purchase, not primarily to protect a security interest; (2) post-foreclosure - as an owner of the site at the time response costs were incurred. The case settled for $100,000 out of over $300,000 in cleanup costs; the consent decree has been entered.

Wilson Concepts Site

The Centrust Savings Bank acquired the Wilson Concepts Site, located in Pompano Beach, Florida, through foreclosure after Chapter 7 bankruptcy proceedings in March 1988. After foreclosure, Centrust leased the Site to Carter and Crawley Precision Metals, Inc., which currently conducts a metal machining operation there. On October 19, 1989, EPA entered into an Administrative Order on Consent with Centrust and CWJ, Inc., the former owner/operator, under whose terms the Respondents would perform an RI/FS.

The RTC was appointed as Conservator for Centrust on February 1, 1990. An information request was sent to Centrust on February 23, 1990 regarding the placement of the Bank in the conservatorship of the RTC and was answered by counsel for the RTC. In April 1990 EPA received a "Notice To Creditors of Centrust Bank," which stated that the Office of Thrift Supervision had appointed the RTC as the receiver of Centrust's assets and liabilities and notified creditors that their claims must be presented to the RTC no later than June 15, 1990. EPA has been granted an extension of time in which to file its claim.

REGION VI

Gulf Coast Vacuum Services site - In re Gulf Coast Vacuum Services Inc.

In this bankruptcy action, Allied Bank of Texas holds a $450,000 mortgage on a contaminated NPL site for which EPA has incurred $500,000 to date in removal costs. A remedy has not been selected. The assets of the debtor's estate are worth about $135,000. EPA filed with the bankruptcy court an application for administrative expenses and an opposition to abandonment of the site by the trustee and is currently negotiating an allocation of the assets with Allied Bank, the major creditor.

United Creosoting Site - Tanglewood East Homeowners Assn. v. First Federal Savings & Loan of Conroe

On October 16, 1989, the United States initiated a cost recovery action for past costs totalling approximately $2 million against a real estate developer and a wholly-owner subsidiary of First Federal Savings & Loan of Conroe Texas. The developer and First Federal's subsidiary were joint venturers who in the mid 1980's together purchased an old telephone pole creosoting facility and converted the property into a real estate development. Their site grading, utility installation, and sewer construction aggravated the existing contamination at the site. A third party action was brought earlier by adjacent residents against First Federal, which has since failed and gone into receivership with the FDIC. The United States did not sue First Federal. Remedial costs are estimated at $22 million.

## REGION VII

Michael Battery Sites - Davenport Bank

The Michael Battery sites are four lead sites in the Davenport/Bettendorf, Iowa are. A lawsuit was filed in the U.S. District Court for the Southern District of Iowa in May 1990, which named a number of PRPs as defendants Although it was not named in the complaint the Davenport Bank is involved at two of these sites the Farragut Road site, at which the bank was a trustee in bankruptcy, and the Bettendorf Site.

The Bettendorf site was the subject of a removal action completed in May 1987. Davenport Bank holds a security interest in the property for approximately $78 000 which is the remainder of a delinquent loan made to the owner/operator In January 1989, EPA filed a Superfund lien against the property to recover part of the costs expended at the site EPA s costs incurred exceed $400,000. In May 1990, the Davenport Bank, SKI Deuce Enterprises (which obtained a judgment lien of $40,000 prior to EPA's removal action), and EPA reached a tentative agreement that allowed for sale of the property based on an existing offer.

## REGION IX

Santa Fe Springs site - U.S. v. John Cauffman

Cerritos Valley Bank held the mortgage on the property and is a third-party defendant in this action. The United States did not name Cerritos as a PRP, but as part of the third-party action Cerritos settled with a payment of $1,000. The settlement was entered on August 3, 1988.

## CERCLA CASES INVOLVING FEDERAL LENDERS

### REGION III

Pennsylvania Department of Environmental Resources v. SBA

In this state enforcement action against the SBA, The State of Pennsylvania's Department of Environmental Resources (DER) has argued that the United States waived sovereign immunity for cleanup of contaminated property under state law.

The SBA guaranteed a loan that the Pennsylvania Development Corporation granted to a wallpaper factory. When the factory defaulted on the loan, the SBA honored its guarantee. Thereafter, the SBA purchased the wallpaper factory site at a sheriff's sale to protect its financial interest in the property. The site contains chemical wastes left there by other persons before SBA acquired the property. The SBA has instituted a program to investigate and remedy the waste situation.

In opposition to the DER's motion for partial summary judgment on sovereign immunity, the United States argued on behalf of the SBA that Congress had waived sovereign immunity only as to objectively-ascertainable or administratively pre-determined standards. The DER had invoked only general environmental laws that authorized establishment of water quality standards and criteria for waste disposal, but did not establish either standards for remedies of sites affected by unintended contamination or mandate comprehensive remedies for such sites. The opposition also cited a liability exemption under state law for certain "Federal corporate instrumentalities." The Pennsylvania Commonwealth Court granted DER's summary judgement motion, holding that sovereign immunity has been waived for the imposition of the particular State laws at issue. Pennsylvania Dep't of Envt'l Resources v. SBA, 125 Misc. Docket 1989 (slip op., Pa. Commw. August 20, 1990).

Turco Coatings site - United States v. Mirabile

In addition to suing American Bank and Trust and Mellon Bank (discussed above), the former landowner also cross-claimed against the SBA. The SBA had loaned money to a paint manufacturing operation, subject to a second mortgage on which it had, however, never foreclosed. SBA representatives had visited the facility several times to monitor liquidation of assets. The court held that this involvement was purely financial and insufficient to make the SBA liable. U.S. v. Mirabile, 15 Envt'l L. Rep. 20944 (E.D. Pa. 2985).

REGION VI

Odessa Chromium I Site - United States v. Bell Petroleum

The United States brought this cost recovery action against Bell Petroleum, seeking about $2 million in past costs and about $2.9 million for a pump-and-treat remedy. In a third-party claim Bell alleged the Small Business Administration was liable as an owner or operator of the site. The SBA had honored its guarantee of a small business loan given in the early 1980s by a bank to a new business (unrelated to Bell's business of chrome-plating) operating out of the site after the borrower defaulted, and had received a security interest in the contaminated property.

The United States argued that the SBA was not an owner or operator because the SBA had not foreclosed, and because its involvement with the site was so limited, notably having occurred long after the operations that had contaminated the property. The SBA had rented the property to a number of small businesses with no known involvement with hazardous substances, and had secured the site against vandalism. On July 24, 1990, the court entered a consent decree between the United States and Bell, which inter alia, dismissed Bell's claims against SBA. United States v. Bell Petroleum Services, No. MO-88-CA-005 (W.D. Tex., filed 1988).

REGION VIII

In re Precious Metals Site, Bonner, Montana

In this state enforcement action, the State of Montana issued an administrative order to HUD requiring cleanup of residential property. The former owner of the site at issue operated a metal finishing facility for about eight years. He ultimately went bankrupt and the lender eventually foreclosed on the property. The lender conveyed the property to HUD in February 1990 through the normal foreclosure process. Subsequently, the Montana Department of Health and Environmental Sciences (DHES) discovered contamination resulting from the finishing facility. On May 18, 1990, DHES notified HUD that it was a potentially responsible party under CERCLA and state law and issued HUD a state administrative order to clean up the site. Cleanup costs are estimated to be between $250,000 and $1,000,000. HUD has contracted out the cleanup of the site and is involved in settlement discussions with the state of Montana.

**CASES INVOLVING PRIVATE LENDERS WHICH DO NOT RESULT IN CERCLA LIABILITY BASED ON A LENDER-BORROWER RELATIONSHIP**

REGION I

Cannons Engineering Superfund Sites

EPA Region I named Tauton Savings Bank and First National Bank as PRPs at the four Cannons Engineering Superfund Sites, located in Bridgewater and Plymouth, Massachusetts and Londonderry and Nashua, New Hampshire. Both Tauton Savings and First National were identified as generators of less than one percent of the waste found at the sites, and entered into de minimis settlements with EPA.

REGION II

Brewster Wellfield site - U.S. v. A & N Cleaners & Launderers

The owner of a small commercial center that contains several businesses leased the entire center to Marine Midland Bank. The Bank has full management rights over the property; they make repairs, have power to make alterations, pay the utilities, etc. One subtenant, a holdover from an earlier lease, is the drycleaner that is suspected of contaminating the groundwater with halogenated hydrocarbons. Marine Midland, as prime tenant/sublandlord, is alleged to be an "owner" or "operator" based on their control over the shopping center. An action seeking $1,559,525 was filed October 16, 1989.

REGION III

Tonnoli Corp. site - In re Tonnoli Corp.

EPA is performing the cleanup of the site owned by Tonnoli Corp., which filed for bankruptcy on October 29, 1985. The U.S. filed a Proof of Claim on June 20, 1986. Our Proof of Claim seeks approximately $38 million. The main secured creditor is Meridian Bank. The bankruptcy trustee has given notice to the court and all parties of its intent to abandon the site. EPA has asked for an administrative expenses priority which Meridian Bank is opposing. Currently EPA is negotiating a settlement with Meridian Bank.

**REGION IV**

American Creosote Works site - In re American Creosote

The Savings Life Insurance Co held the mortgage to the site with American Creosote Works which had declared bankruptcy under Chapter 11 EPA entered into an agreement in the debtor's bankruptcy proceeding with Savings in 1986 under which the Agency will get title to the cleaned-up property and will split the proceeds of the eventual sale of the property with Savings. Total estimated cost of the remedy is $10 - 12 million.

**REGION V**

T.P. Long Chemical site - In re T.P. Long Chemical Inc.

EPA sought reimbursement of removal costs from the assets of a bankrupt owner's estate, including funds in which BancOhio held a security interest. The Federal Bankruptcy Court held that EPA could not recover its costs from funds subject to BancOhio's security interest. (In re T.P. Long Chemical Inc., 15 ELR 20635 (Bankr. N.D. Ohio Jan. 3, 1985)).

I. Jones Recycling Sites, Fort Wayne, Indiana

The Valley American Bank has been identified as a PRP at these sites based on its arranging for disposal of wastes originally found at properties which it acquired through foreclosure. The Bank had no lender-borrower relationship with the owner/operators of I. Jones Recycling. The Bank has entered into a de minimis settlement in this matter.

Better Brite Zinc Shop site - In re Better Brite Plating

The Better Brite Zinc Shop site is proposed for inclusion on the NPL and the corporate owner/operator is in bankruptcy. The United States filed a proof of claim for approximately $143,000 on February 26 1987 EPA's present estimate of the total cost of the removal action is $440,000. No RI/FS has yet been done to determine the need for or cost of remedial action. Recently, the bankruptcy court allowed as an administrative expense the United States' claim for environmental costs incurred at the site after the debtor filed its Chapter 11 petition University Bank is a secured creditor of the debtor. In the same ruling the bankruptcy court declined to order that a Trustee can use a Bank's collateral in uncontaminated assets of the debtor to fund environmental cleanup. The State of Wisconsin had sought this relief and lost on appeal to the Eastern District Court of Wisconsin The State appealed to the Seventh Circuit. The Court granted the Bank's motion to dismiss the appeal as moot because EPA had recently removed all but one drum from the Site.

<u>Enviro-Chem Corporation site</u>

The Farmer's Production Credit Association (FPCA) of Scottsburg, Indiana is one of about 300 PRPs sued by the United States for cleanup costs at this site. FPCA is allegedly liable as a waste generator, having sent 4 shipments of waste paint totaling 7752 gallons to the site in 1981. In 1983 they joined into a partial settlement for partial cleanup for $5,503, and have recently signed, as a <u>de minimis</u> generator, a proposed consent decree which is under consideration by the Justice Department.

REGION VI

<u>Automation Techniques Inc., Site - In re Edward Leigh Covington</u>

In this bankruptcy action, the trustee in bankruptcy has petitioned the bankruptcy court to abandon the site, which is contaminated with PCBs and other hazardous substances. The FDIC became the receiver of a failed bank which held the $715,000 mortgage for the site, but which did not foreclose. EPA estimates the cleanup will cost $350,000. The value of the property once cleaned will be between $400,000 and $500,000. EPA and the FDIC, the only two parties to oppose the abandonment, attempted to negotiate an allocation of lien priorities, but negotiations have been postponed. <u>In re Edward Leigh Covington</u> (Bankr. N.D. OK). Region VI has issued CERCLA § 106 Administrative Orders to three PRPs, including the debtor in bankruptcy. The debtor, as co-owner of the Site, recently filed an adversary proceeding against the FDIC and EPA requesting the dismissal (or discharge) of all obligations he may have under CERCLA and requesting the foreclosure on the property by the FDIC.

REGION VIII

California Gulch site - <u>U.S v. Apache Energy & Minerals Co.</u>

On August 6, 1986, the United States filed an action under §§ 106 and 107 of CERCLA against 13 defendants at the California Gulch site, including Atlas Mortgage Company-Colorado, Inc. The complaint alleges that Atlas "owned or operated" mining claims draining into the Yak Tunnel and that it conducted mining or mineral processing activity on the property. Estimated cost of the remedial action for the first operable unit is $30 million.

<u>Broderick Wood Products site - Broderick Investment Co.</u>

The Colorado National Bank and First Interstate Bank settled with the United States by consent decree entered May 21, 1986. The Banks were trustees of certain family trusts and therefore general and limited partners of the Broderick Investment Company (BIC). BIC is a partnership into which all of the assets of Broderick Wood Products have been liquidated. The Banks were involved in their representative capacity only, and were not themselves considered PRPs. The remedial action for the first operable unit is estimated to cost $7-10 million.

**EXHIBIT C**

**PRELIMINARY LIST OF LENDING INSTITUTIONS WHICH WERE SENT CERCLA INFORMATION REQUESTS PURSUANT TO § 104(E), GENERAL NOTICE LETTERS, OR SPECIAL NOTICE LETTERS**

The list is divided into three categories representing the initial basis for sending the information request or notice letter. These three categories are: 1) information EPA had indicating that they may have operated or otherwise managed the site; 2) information EPA had indicating that they may have generated or sent waste to the site; and 3) information EPA had indicating that they may have held title or other indicia of ownership for the site. Each individual entry includes site name, lending institution name, and EPA Region (in parenthesis).

1) EPA sent an information request, general notice letter, or special notice letter to the following lenders on the basis of information EPA had indicating that they may have operated or otherwise managed the site:

Kearsarge Metals site - <u>Fleet Bank - New Hampshire</u> (successor to Indian Head Bank), <u>Indian Head Bank</u>, <u>Northern Community Investment Corp.</u>, and <u>Farmers Home Administration</u> (I)
Silresim Chemical Corporation site - <u>State Street Bank and Trust Company</u> and <u>Union National Bank</u> (I)
Brewster Wellfield site - <u>Marine Midland Bank</u> (II)
Fort Hartford Stone Quarry site - <u>First National Bank of Louisville</u> (IV)
Pembroke Road/Petroleum Products Corporation site - <u>Barnett Banks Trust Company and Flagship National Bank of Broward County</u> (IV)
Nichro Plating Company site - <u>Peoples Bank of Mt. Washington</u> (IV)
Swainsboro Print Work site - <u>Fleet Factors Corporation</u> (IV)
S.E.R. Plating, Inc. site - <u>Commercia Bank</u> (V)
Interchem site - <u>Small Business Administration</u> (VII)
Bee Cee Manufacturing site - <u>First State Bank of Missouri</u> (VII)
White Farm Equipment site - <u>Borg-Warner Acceptance</u> (VII)
Smuggler Mountain site - <u>Silver King Investments</u> (VIII)
Montana Pole site - <u>Miner's Bank</u> (VIII)
Selma Pressure Treating Company site - <u>First Interstate Bank of California</u> (IX)

2) EPA sent an information request, general notice letter, or special notice letter to the following lenders on the basis of information EPA had indicating that they may have generated or sent waste to the site:

Cannon's Engineering Corporation sites - <u>First National Bank and Taunton Savings Bank</u> (I)
Donaldson Art site - <u>Bank of New England</u> (IV)
Nichro Plating Company site - <u>Peoples Bank of Mt. Washington</u> (IV)
Enviro-Chem Corporation site - <u>Farmer's Production Credit of Scottsburg</u> (V)

I. Jones Recycling site - Valley American Bank and Trust (V)
Missouri Electric Works site - Intercontinental Bank, International Bank of Miami (VII)

3) EPA sent an information request, general notice letter, or special notice letter to the following lenders on the basis of information EPA had indicating that they may have held title or other indicia of ownership for the site:

Kearsarge Metals site - Fleet Bank - New Hampshire (successor to Indian Head Bank), Indian Head Bank, Northern Community Investment Corp., and Farmers Home Administration (I)
Keefe Environmental Services site - United Federal Savings and Loan (I)
Mini-Self Storage Removal site - Maine National Bank (I)
Saco Tanning Waste Pits site - Finance Authority of Maine (I)
Synkote Paint site - National Community Bank of New Jersey (II)
Li-Tungsten site - Old Court Savings & Loan (II)
L.A. Clarke site - Crestar Bank of Maryland (III)
McAdoo site - First Valley Bank (III)
M W Manufacturing site - Philadelphia National Bank (III)
Cedartown Landfill/Cedartown Battery - AmSouth Bank (IV)
Wilson Concepts site - Centrust Savings, Centrust Federal Savings Bank, Great Western Bank (IV)
Anodyne, Inc. site - Southeast First National Bank of Miami (IV)
Airco Plating site - Commercial Bank and Trust Company, Florida Capital Mortgage Co., Biscayne Federal Savings and Loan, Citizen Federal Savings and Loan (IV)
Bay Drum site - MDC Financial Corp. (IV)
Parson's Casket site - Belvidere National Bank and Trust (V)
Tri-county Landfill site - Michigan Avenue National Bank of Chicago (V)
Pagels Pit site - Illinois National Bank of Rockford (V)
Byron Salvage Yard site - Aurora National Bank (V)
NL Industries site - First Granite National Bank (V)
Cal-West Metals site - Small Business Administration (VI)
MOTCO, Inc. site - Mainland Bank & Trust (VI)
InterChem, Inc. site - First Federal Savings and Loan, Sioux Valley Savings and Loan (VII)
Broadway Salvage Oil Disposal #3 site - Modex Investments (VII)
Aidex site - Toy National Bank (VII)
29th and Meade (Wichita) site - United American Bank and Trust Company (VII)
Kansas City Structural Steel site - BancAmerica Commercial Corporation (VII)
Elliot Shooting Park site - Boatman's First National Bank (VII)
Montana Pole site - Miner's Bank (VIII)
California Gulch site Atlas Mortgage Company (VIII)
Sand Creek Industrial site - First Interstate Bank of Denver (VIII)
Smuggler Mountain site - Silver King Investments (VIII)
Harbor Island Lead site - Peoples National Bank (X)

3

Commencement Bay - Nearshore/Tideflats site - American Savings Bank (X)

RESPONSE TO WRITTEN QUESTIONS OF SENATOR HEINZ FROM

JAMES M. STROCK

**UNITED STATES ENVIRONMENTAL PROTECTION AGENCY**
**WASHINGTON, D.C. 20460**

DEC 7 1990

OFFICE OF ENFORCEMENT

The Honorable John Heinz
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, DC 20510

Dear Senator Heinz:

Thank you for the opportunity to discuss with you EPA's views on lender liability under the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA") during the July 19, 1990 hearing held before the Senate Subcommittee on Banking, Housing and Urban Affairs. By this letter, I am submitting answers to the written inquiries you forwarded to EPA on July 20, 1990.

As the enclosure indicates, the Agency has undertaken an extensive survey of our regional offices in order to provide the data sought in your July 20, 1990 letter. I hope these responses assist you in your consideration of this important matter. If you have any questions regarding these responses, please contact me or have your staff contact David B. Van Slyke, the Acting Associate Enforcement Counsel for Superfund. Mr. Van Slyke can be reached at 382-3050.

Sincerely yours,

James M. Strock
Assistant Administrator

Enclosure

**RESPONSE TO FOLLOW-UP QUESTIONS FROM SENATOR HEINZ RESULTING FROM THE JULY 19, 1990 HEARING BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS**

Question, No. 1

"Hopefully the current obligations on banks and S&Ls have encouraged careful underwriting practices by lenders. But, it appears that S. 2827 would only impose liability on lenders if they had ACTUAL knowledge of an environmental problem. Mightn't that actually encourage lenders to ignore environmental risks? Won't lenders be afraid to learn anything about the environmental risks of their borrowers?"

Response to Question No. 1

S 2827 states that insured depository institutions and mortgage lenders will be exempt from "any law imposing strict liability for the release threatened release, storage or disposal of hazardous or potentially dangerous substances from property [they] acquired through foreclosure, held in a fiduciary capacity, or held controlled or managed pursuant to the terms of an extension of credit," unless the lender had caused the release, had actual knowledge of the release and failed to take steps to mitigate it, or benefited from EPA s response action. (See, Section 35 of the proposed "Lender Liability Act of 1990".)

As noted in the testimony of Mr. James M. Strock before the House Subcommittee on Transportation and Hazardous Materials of the Committee on Energy and Commerce (see Exhibit A), one of EPA s goals is to allow lenders or other security interest holders to foreclose on properties in order to protect their security interest without automatically triggering CERCLA liability. However, we believe the "security interest" exemption also should be coupled with provisions that foster where appropriate, responsible loan inquiry and site management practices. It is in the best interests of the lender to undertake environmental investigations when making the loan, not only to assess potential environmental liabilities, but to ensure that the collateral used to secure the loan has some value. Also, it is expected that the lenders will continue to act reasonably once contamination is discovered and that they will exercise due care in managing the property so that the contamination is not exacerbated.

Question, No. 2

"S. 2827 appears to exempt lenders from liability even if they become involved in the day-to-day operations of a troubled borrower. If the lender doesn't pay for his share of the clean-up costs of contamination, who does? The taxpayer?"

Response to Question No. 2

It is EPA's position that when a lender affirmatively undertakes activities that constitute management of a facility, especially activities which cause or contribute to environmental harm, such a lender is no longer entitled to the "security interest" exemption, and could thus be responsible for paying for the cleanup.

If the lender can demonstrate, however, that it falls within the "secured creditor" exemption, the costs incurred by EPA as a result of cleaning up the contamination will be borne by the remaining potentially responsible parties, by States with similar "Superfunds," and by the taxpayers should these two sources be inadequate to reimburse the federal Superfund.

Question No. 3

"Some have suggested that by exempting banks and S&Ls from Superfund liability, nonlenders might find ways to restructure a company's ownership to hide behind a bank---say, by setting up a trust. Can EPA envision such scenarios under S. 2827? And how, then, would you be able to bring an enforcement action?"

Response to Question No. 3

EPA is concerned about any statutory scheme which could encourage the creation of "sham" business entities for the purpose of limiting CERCLA liability; however, it is difficult to predict whether any particular provisions in S. 2827 would have such an effect. It may be possible, under a statute that provided a blanket exception for commercial lending institutions acting as trustees, for individuals or for companies to limit their liability by restructuring their businesses as trusts, appointing a bank as the trustee, designating themselves or their investors as beneficiaries and owning or operating CERCLA facilities through the bank or the trust. In this type of arrangement, the trust itself would be the owner or operator of the facility and potentially a CERCLA liable party, and the bank, though the operator, would be shielded from liability. The beneficiaries of the trust could be protected from liability despite having profited from the enterprise How frequently such an arrangement might occur would depend on a business's willingness to relinquish control over operations to a lending institution that could avail itself of the trustee liability exemption, and on the lending institution's willingness to take on such responsibilities.

Of greater concern would be a statute that provided blanket protection extending to "trustees" in general. There can be situations where the trustee of a business or realty trust is, instead of a bank, one and the same with the beneficiary. In

these instances, beneficiaries of such "sham" trusts should be (and have been) held liable for ownership or operation of CERCLA facilities. See U.S. v. Burns, No. 88-094-S (D.N.H. August 9, 1990) EPA and the Department of Justice are working to develop a better understanding of the many types of trust arrangements companies are capable of structuring.

Question No. 4

"The Banking Committee has been spending most of its time trying to manage the S&L crisis. In EPA's view, does Superfund liability encourage or discourage S&Ls from making sound loans? Would more bad loans be written if S. 2827 were adopted because lenders would be discouraged from assessing environmental risks? Could these additional bad loans place the S&Ls and banks in an even more precarious financial position?"

Response to Question No. 4

Again, EPA believes that allowing holders of security interests to protect those interest without triggering CERCLA liability, coupled with provisions that foster responsible loan inquiry and site management practices, will encourage sound financial and environmental practices by lenders. It is in the best interests of the lender to undertake environmental investigations when making the loan, not only to assess potential environmental liabilities but to ensure that the collateral used to secure the loan has some value. Also, we would expect that the lenders will continue to act reasonably once contamination is discovered and that they will exercise due care in relation to the property so that the contamination is not exacerbated Actions taken by lenders which cause or contribute to the exacerbation of the contamination at the site will subject them to Superfund liability It is difficult to anticipate how the incentives to undertake environmental audits before making and during the life of the loan may be altered by the changes to the statutory scheme.

Question No. 5

"S. 2827 would preempt state laws. Could you tell the Committee how many states have Superfund laws that would be affected? What effect would the legislation have on common law? What effects could this have on the statutory requirements for "strict liability" and the statutory definitions of "joint and several?"

Response to Question No. 5

To EPA's knowledge, 22 States expressly or impliedly have strict, joint and several liability standards in their State Superfund laws (Connecticut, Maine, Massachusetts, New Hampshire,

Rhode Island, Vermont, New Jersey, Pennsylvania, Florida, South Carolina, Illinois, Indiana, Minnesota, Ohio, Louisiana, Texas, Iowa, Montana, Arizona, Alaska, Oregon, and Washington). A number of these liability schemes, however, provide that if a party can establish by a preponderance of the evidence that its liability is divisible, the party is only responsible for its proportional share. Any "orphan" shares which are not attributable to the responsible parties are borne by the State. The enactment of S. 2827 may, therefore, affect these States both by altering their present liability scheme and by requiring the States to absorb the clean up costs associated with larger orphan shares.

At least two States - Montana and Pennsylvania - of these 22 have a "security interest" exemption from the definition of "owner" in their Superfund statutes. Pennsylvania's new Hazardous Sites Cleanup Act Title 35, Chapter 29C (1988), for example, exempts, like the federal statute, "a person who, without participating in the management of a site, holds indicia of ownership primarily to protect a security interest," and it exempts a governmental entity that acquires the property involuntarily "by virtue of its function as a sovereign." (See, 35 P.S. §6020.103 (1988)).

In your home State of Pennsylvania, however, the exemption is more specific than CERCLA §§ 101(20) and 101(35), since it excludes from its definition of "owner or operator" financial institutions, their affiliates or parents, or a corporate instrumentality of the Federal Government, which acquired the site by foreclosure before it knew the site was listed on the National Priorities List (or corresponding State list) and did not manage or control activities at the site which contributed to the release or threatened release of the hazardous substance. "Management" does not include participation in or supervision of the finances or fiscal operations of the company in connection with the loan or actions taken to protect or preserve the value of the site or operations conducted on the site.

The exemption in S. 2827 excuses lenders liable under <u>any</u> law, statutory or common law, which imposes strict liability for the release, storage or disposal of hazardous substances from property acquired through foreclosure and held in a fiduciary capacity. This exemption applies provided the lender did not cause the release, have actual knowledge of the release and failed to mitigate it, or benefit from the removal or remedial action. It appears that S 2827 would thus pre-empt the more stringent State standards and would excuse from liability under both CERCLA and RCRA-type State laws (like Underground Storage Tank regulations as well as common law, any person who "held, controlled or managed" properties from which hazardous substances are or may be released, if such holding, control or management is undertaken "pursuant to the terms of an extension of credit."

*See*, S. 2827, 101st Cong., 2d Sess., Sec. 35(b), "Exemption From Liability for NonCulpable Activities," (June 28, 1990).

Question No. 6

"I am concerned that we may be bailing out lenders for making poor lending decisions by adopting S. 2827. In your view, could the Superfund program be left holding the bag if a lender was one of several parties responsible for an NPL site?"

Response to Question No. 6

The CERCLA liability scheme provides for "joint and several" liability of all responsible parties at a given Superfund site where the harm necessitating response is not divisible. If the lender merely holds indicia of ownership primarily to protect its security interest, it will not be considered a liable party and any remaining PRPs will be responsible for paying the total cleanup costs. Assuming these remaining PRPs are viable, the Superfund program will not be "left holding the bag " In circumstances where costs are divisible however the Fund's share may increase to cover the cost of the orphan share and that cost would be borne by the Superfund, which is made up of revenues from a number of sources, including general revenues contributed by the taxpayers. Where there is no other viable party, the Fund will pick up the entire cost of the cleanup.

Question No. 7

"Has EPA ever pursued a lending institution under CERCLA when the institution was merely protecting its security interest? Does EPA seek out lending institutions as "deep pocket" defendants?"

Response to Question No. 7

Attached for your information are several lists of Superfund sites and cases where lending institutions are involved (See Exhibits B and C) As you know views of what activities constitute "merely protecting" a security interest can vary greatly. EPA does not have a policy of seeking cost recovery only from "deep pockets" regardless of whether the potentially responsible party is a lending institution or a private sector entity. In fact, the current policy is to ensure that a significant majority of a site's PRPs are brought into the litigation/settlement process.

Question No. 8

"What kind of protection is there for lending institutions sued by private parties in Superfund cost recovery actions? Are lending institutions subject to unlimited liability in such

lawsuits?"

Response to Question No. 8

First lenders have the protection afforded by the "security interest exemption" found in Section 101(20 of CERCLA. Second, under operation of law, if a PRP comes forward and settles with EPA for any CERCLA liability, that PRP is afforded contribution protection for the matters addressed in the settlement. Pursuant to Sections 101 35 and 107 b) 3), a lending institution may also be able to prove that it was an "innocent landowner," i.e. that after conducting all appropriate inquiry at the time of acquiring the property, it did not know and had no reason to know that the property was contaminated and did nothing to cause or contribute to the problem.

Question No. 9

"If a lender waited to foreclose until after the government cleaned up a Superfund site with Fund monies, wouldn't the lender unfairly reap the benefit of government cleanup efforts from a sale of the property after foreclosure?"

Response to Question No. 9

EPA believes that whenever Superfund monies are expended to conduct a response action, the Superfund should be entitled to recoup the benefit conferred on the holder of a security interest as a result of EPA's cleanup. Although the specific distribution of funds received from the sale of a cleaned-up Superfund site as among the lender the borrower and the United States is a very complex matter, one of the goals of EPA's forthcoming rulemaking, as noted in the testimony of Mr. James M. Strock, Assistant Administrator for Enforcement. is to address the concern expressed by some entities that "the lender [would] unfairly reap the benefit."

Question No. 10

"Has EPA ever named the RTC or FDIC as a potentially responsible party in a Superfund lawsuit?"

Response to Question No. 10

EPA has not named either the FDIC or the RTC as a potentially responsible party in any CERCLA civil action. However, as Exhibit B indicates, we have been involved with sites where the FDIC and the RTC are also involved.

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